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No.

Supreme Court, U.S.
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In The

The Supreme Court of the United States

October Term, 1992

THE PARSONS CORPORATION AND
THE RALPH M. PARSONS COMPANY,

Petitioners,

v.

STATE OF ALASKA, DEPARTMENT OF REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ALASKA

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Do Alaska's tax adjudicative procedures (*viz.*, the power of the Commissioner of the Department of Revenue to decide tax controversies and thwart judicial review) create such a predilection for bias, as evidenced by the fact that no nonresident corporation has ever prevailed in the Alaska Supreme Court in an income tax case, that no meaningful opportunity for a hearing exists?

2. Were the Alaska Supreme Court's *de facto* denial of the existence of stipulated facts and articulation of new rules of law based upon the nonexistence of such facts adequate and tenable state grounds for avoiding this Court's review?

3. Did the Alaska Supreme Court's application of Alaska law to a contract between California residents who (1) selected California law to govern the interpretation of their contract, and (2) negotiated, signed and predominantly performed their contract in California, unduly burden interstate commerce and effect cumulatively a deprivation of due process of law?

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No.

THE PARSONS CORPORATION AND
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Petitioners,

v.

STATE OF ALASKA, DEPARTMENT OF REVENUE
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ALASKA

Petitioners respectfully request this Court to issue a writ of certiorari to review the judgment of the Supreme Court of Alaska or, in the alternative, to reverse summarily the Alaska Court's judgment.

OPINIONS BELOW

The opinion of the Supreme Court of Alaska (A. 1a) is reported at 843 P.2d 1238 (Alaska 1992). That Court's order denying Petitioners' Petition for Rehearing (A. 12a) is unreported. The opinion of the Superior Court of the State of Alaska (A. 14a) is an unreported decision. The opinion of the Alaska Department of Revenue ("DOR") Hearing Officer (A. 26a) is also unreported.

JURISDICTION

In response to Petitioners' Petition For Rehearing (A. 113a), the Alaska Supreme Court ("the Alaska Court") withdrew its previous opinion, substituted its final judgment dated December 31, 1992, and denied Petitioners' Petition for Rehearing except to the extent the final judgment was modified from the previous opinion. This petition is timely filed. This Court has jurisdiction under 28 U.S.C. §1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The relevant portions of the following constitutional and statutory provisions are reproduced in A. 123a: United States Constitution, Article I, section 8, clause 3 (the Commerce Clause); United States Constitution, Amendment XIV, Section 1 (the Due Process Clause); and Alaska Statutes ("AS") 43.19.010, Art. IV. (the Uniform Division of Income For Tax Purposes Act, "UDITPA"); AS 43.05.150, AS 43.05.010, AS 44.25.020, AS 44.25.010, AS 43.05.040, and 43.05.240.

STATEMENT OF THE CASE

The Parsons Corporation, its subsidiary, The Ralph M. Parsons Company and their subsidiaries ("Engineer") comprise one of the world's largest engineering organizations. Engineer's group of companies supports the worldwide environmental, transportation, energy, and natural resource industries and government clients. See A. 129a for a list of subsidiaries under Rule 29.1.

Beginning in 1971, Engineer contracted with an independent oil company ("OILCO") to design, procure and fabricate oil and gas field facilities for Prudhoe Bay, Alaska. One of Engineer's assignments was to purchase materials and equipment for the project. OILCO and Engineer agreed their relationship would be governed by California law.

The DOR and Engineer stipulated to the following facts, *inter alia*, about Engineer's and OILCO's relationship:

(1) OILCO exercised absolute "control over the procurement process from acquisition to final approval, including from whom, under what terms, what type, how and where the materials were acquired";

(2) Engineer could procure materials only from specific OILCO-approved vendors;

(3) OILCO required its approval for all but *de minimis* materials purchases and OILCO's counsel approved the terms and conditions of all purchase contracts;

(4) Engineer did not warrant materials it procured for OILCO; OILCO assumed all risks of loss and insured all materials acquired against loss or damage;

(5) OILCO funded all procurement and controlled use of its money through a zero balance account ("ZBA") bank account at OILCO's bank. ZBA deposits could only be used for OILCO-approved purchases and subcontracts;

(6) For materials procured outside Alaska, formal legal title vested in OILCO when the materials were received in Alaska;

(7) OILCO could compel Engineer to transfer any procured materials anywhere, even another state or country, without additional compensation, because the parties regarded the materials as always owned by OILCO;

(8) OILCO had direct contractual privity with vendors for guarantees, inspection rights and indemnifications.

California and Alaska have adopted UDITPA as the method for apportioning income between the states. UDITPA satisfies the Commerce and Due Process Clauses by apportioning a taxpayer's income among different states through use of a three factor formula based upon property, payroll and sales. The sales factor sections source revenue

from the sale of tangible personal property to the property's destination and source all other revenue, including revenue from services, to the place where the majority of costs of performance are incurred (outside of Alaska in the instant case).

After reviewing the contracts between Engineer and OILCO, the DOR auditor contended that Engineer was not OILCO's agent, but rather a seller of property, and sourced Engineer's revenues from its OILCO contracts to Alaska even though Engineer's services were performed outside Alaska. Engineer appealed this determination to a DOR "Formal Hearing."

The DOR was represented at the Formal Hearing by the Hearing Officer appointed by the DOR Commissioner and a DOR attorney acting as the DOR's advocate.[1] The DOR Hearing Officer upheld the DOR auditor and found that Engineer sold property rather than acted as agent.

As required under Alaska law for the DOR Hearing Officer decision to become effective, the decision was approved and adopted by the DOR Commissioner. *See* AS §44.25.020, Alaska Admin. Code tit. 15, §05.030.

Engineer appealed the Commissioner's Formal Hearing decision to the Alaska Superior Court (hereafter "the Lower Court") under AS §43.05.240(d).

The Lower Court applied the independent judgment standard of review and substituted its own judgment for the DOR's on legal matters. The Lower Court reversed the Hearing Officer and held that Engineer provided purchasing agency and engineering services to OILCO and should not be taxed as a seller of property.

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[1] The same person acted as both the informal hearing officer and the DOR attorney representing the DOR before the DOR Hearing Officer.

The DOR appealed the Lower Court's decision to the Alaska Court. On December 31, 1992, the Alaska Court first ruled on the appropriate standard of review by Alaska Courts on DOR decisions, holding Alaska Courts *"will not reverse DOR's decision if there is a reasonable basis to support it."* (Italics added). (A. 6a).

Both parties to this case agree that an agent cannot sell property procured as agent of the principal. Thus, the central issue before the Alaska Court was correctly summarized by the court as follows:

> The income tax results in this case depend upon the classification of [Engineer's] business activity. If [Engineer] acted as a manufacturer and seller of oil field modules its revenues were for the 'sale of tangible personal property.' If Engineer acted as a contractor who procured materials as a purchasing agent and was paid for skills and services provided, its revenues were from sales other than sales of tangible personal property. (A. 7a).

Because Alaska tax law has adopted no special rules to characterize the relationship of the parties for tax purposes, the Alaska Court looked to Alaska general agency law. The Alaska Court analyzed the issue in a single footnote rejecting the application of California agency law, citing no authority for such rejection, and omitting the material facts stipulated by the parties and relied upon by the Lower Court.[2] (A. 8a).

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[2] The Alaska Court did not mention the principal Alaska decision, *Green Construction Company v. State, Department of Revenue*, 674 P.2d 260 (Alaska 1983), relied upon by the Lower Court, the Hearing Officer, the Attorney General, and Engineer. Engineer also specifically requested that the Alaska Court address the omitted facts in Engineer's Motion for Rehearing. (A. 119a). While the Alaska Court corrected other errors in its opinion, including erroneous reliance on a regulation,

The footnote stated that Engineer took title to materials procured for OILCO until delivered, hired and insured its own employees, warranted its engineering work, was labeled an independent contractor and used its name on top of the purchase orders. The Alaska Court nevertheless acknowledged that Engineer provided agency services.[3]

The Alaska Court stated "we are satisfied that the record contains a reasonable basis to support DOR's Decision 88-67" and held in favor of the Commissioner, thereby disregarding the Lower Court's decision and analysis. (A. 10a).

In upholding the imposition of additional Alaska taxes, the Alaska Court held, "[E]ven though most of Parsons' activities are conducted *outside of Alaska*, it is perfectly appropriate to attribute *all* of its revenues to Alaska, for sales factor purposes." (Italics added.) (A. 11a).

The determination of whether Engineer was an agent affects its rights and responsibilities in myriad areas of the law, including torts, contracts, sales, construction law, environmental liability, property and taxes. Here the effect of the agency question is on taxes, but the parties have stipulated the amount of taxes which will be paid if Engineer is and is not determined to have been an agent.

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it refused to address the stipulated facts in its revised opinion. (A. 2a-4a).

[3] The Alaska Court stated "Parsons provided engineering, design, and agency procurement services from its home office in California." (A. 4a).

REASONS FOR GRANTING THE WRIT

I. THE ALASKA COURT OPINION DENIES ENGINEER DUE PROCESS OF LAW BY ARTICULATING ONLY THE FEW FACTS SUPERFICIALLY INCONSISTENT WITH AGENCY AND REFUSING TO ADDRESS THE LOWER COURT'S ANALYSIS AND FACTS DEMONSTRATING AGENCY

This case is part of a growing trend for state supreme courts to reverse well-reasoned lower court opinions with opinions which distort the nature of the case and hide the fallacy and partiality of the state supreme court's logic.

A comparison of the facts and arguments discussed in the Lower Court's unpublished opinion (A. 14a) to the facts and arguments articulated in the Alaska Court's opinion ("the Opinion") leaves the vivid impression that they are two completely different cases. The Opinion discusses only those of the stipulated facts which superficially support its ultimate conclusion and ignores those facts (even though stipulated), which it cannot square with its conclusion.

Applying the test of *Mathews v. Eldridge*, 424 U.S. 319 (1976) to our facts, the "fundamental fairness" and "meaningful hearing" requirements of due process mandated that the Opinion describe the case candidly to expose the court's logic to public scrutiny. The *Mathews* test is applied below. Although other procedural protections often provide due process, this Court has frequently required important judicial and quasi-judicial decisions to be explained. *Taylor v. McKeithen*, 407 U.S. 191, 194-195 (1972); *Morrissey v. Brewer*, 408 U.S. 471, 486-487 (1972); *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 43 (1983). Here, there are no other procedural safeguards in place to provide due process because it was the state supreme court which did not meaningfully explain its reversal.

When an administrative agency or a lower court obscures the real issues and facts in a case, the litigant invariably has an appeal process available which most often cures the problem and provides due process of law. However, when a state supreme court obscures the true nature of the litigation, due process and other federal constitutional rights are often, as here, denied.

Fundamentally more serious than a failure to give any reason for an opinion is for an opinion to give a distorted picture of the case. Where there is a complete absence of explanation of the central reasoning of a case, the public is put on notice that a court does not want its logic scrutinized. A false reason gives no such warning. *See Townsend v. Burke*, 334 U.S. 736 (1948) holding that it is a violation of due process to base a sentence on materially false information, and *Monroe v. Thigpen*, 932 F.2d 1437, 1442 (11th Cir. 1991).

The Alaska Court's Opinion appears to be adequately grounded but hides the fact that it completely disregards the law of the contract jurisdiction, the Restatement of Agency, Alaska's own case law and the material stipulated facts.

In contrast to the borderline facts mentioned by the Alaska Court, all of the undisputed facts which the Court ignored indicate that Engineer was OILCO's agent. The articulated peripheral facts were explained away convincingly and easily by the Lower Court. An agent does not have to be disclosed, an agent can have bare legal title, and an agent can be responsible for its own taxes, employees' torts and defective work.

The Due Process Clause forbids the deprivation of property without due process. The imposition of a tax is a "deprivation of property." *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 36 (1990) (due process requires the state to provide a *meaningful opportunity to contest taxes*).

Due Process requires the policy being served by the State's procedure to be weighed against the burden placed on its targets:

> First, the private interest that will be affected by the official action; second, the risk of an erroneous deprivation of such interest through the procedures used, and the probable value, if any, of additional or substitute procedural safeguards; and finally, the Government's interest, including the function involved and the fiscal and administrative burdens that the additional or substitute procedural requirement would entail. (Citation omitted). *Mathews v. Eldridge*, 424 U.S. at 335.

The private interests affected by the official action are the Engineer's right to engage in, and enjoy the fruits of, interstate commerce and property rights in its money, which the DOR seeks to take. While the primary purpose of the Commerce Clause is to protect commerce, the right to engage in interstate commerce is also an important private right. *Dennis v. Higgins*, 498 U.S. 439 (1991). Protection of the national economy, the common market of the United States, is also a very important public interest.

On the second factor (the risk of erroneous deprivation and probable value of alternative procedural safeguards), failure to articulate an answer to the central reasoning of the Lower Court (which the Alaska Court overturned) deprives the litigants of the advantages of exposure of the Opinion's principal reasoning to public scrutiny. Such scrutiny increases its legitimacy and enhances its value as a predictor of development of the law. *Greenholtz v. Inmates of Nebraska Penal & Correctional Complex*, 442 U.S. 1, 34-35, 40 (1979) (Marshall, J, dissenting in part, "the obligation to justify a decision publicly would provide the assurance, critical to the appearance of fairness, that the Board's decision was not capricious."); *Connecticut Bd. of*

Pardons v. Dumschat, 452 U.S. 458 (1981) (Stevens, J., dissenting from a majority holding that Mr. Dumschat was not being deprived of "life, liberty, or property"):

> [Courts'] explanations of why they decided cases as they did provided guideposts for future decisions and an assurance to litigants that like cases are being decided in a similar way. [T]hose statements of reasons provided a better guarantee of justice than could possibly have been described in a code written in sufficient detail to be fit for Napoleon.

The merits of the substantive claim are irrelevant to due process. *Fuentes v. Shevin*, 407 U.S. 67, 92 (1972). However, had the Alaska Court articulated its analysis of the actual facts and arguments, it would have had a difficult time in justifying its decision.

The Alaska Court's legitimate interests in avoiding candor on the central question in cases are weak. Accurately describing the case might hurt speed and efficiency, but "[T]he Constitution recognizes higher values than speed and efficiency." *Stanley v. Illinois*, 405 U.S. 645, 656 (1972).

II. THE ALASKA PROCEDURE FOR ADJUDICATING INCOME TAX CASES VIOLATES DUE PROCESS BY DENYING ACCESS TO AN IMPARTIAL DECISION MAKER

The State of Alaska has violated due process of law by subjecting Engineer to an unconstitutionally biased administrative process because the opinion of the Hearing Officer is not effective until adopted by the Commissioner (Alaska Admin. Code tit. 15, § 05.030(i)), the very person responsible for collecting taxes, and may not be reversed by any Alaska court as long as the Commissioner has a

"reasonable basis." (A. 6a). This is true even if the DOR is wrong.

Alaska's "reasonable basis" standard of review must be barred if the guarantee of due process is to have meaning because the DOR Commissioner has a conflict of interest between his mission to collect taxes and his role as final authority in the administrative adjudication of disputes with out-of-state taxpayers. This process can only satisfy due process if the Commissioner's decisions are subjected to an "independent judgment" standard of review.

The essence of Alaska's appellate review of tax cases is that the DOR conducts an audit of taxpayers, the DOR evaluates out-of-state taxpayers through an informal hearing, the DOR attorney representing the DOR at the informal hearing represents the DOR before a hearing officer employed by the DOR. The DOR hearing officer is appointed by the Commissioner of the DOR and is required to obtain the approval of the Commissioner before the hearing officer's decision is final.

While the case may be appealed to the lower court, according to the Alaska Court, the lower court must uphold the DOR's decision so long as there is a "reasonable basis" for it. If there is a reasonable basis, the Lower Court cannot reverse the DOR even if it is convinced that the DOR is wrong. This procedure is inherently prejudicial and unconstitutional.

As a result, Alaska has created a tax collection process in which the DOR never loses. The Alaska Court has found in favor of the DOR in every corporate income tax appeal from the lower courts' review of Hearing Officer decisions. See A. 130a for a list of all DOR cases appealed to Alaska Court.

Here, the Alaska Court ignored the stipulated facts, the stipulated independent judgment standard of review, cited

authority, California agency law and its own finding that Engineer provided purchasing agency services to OILCO.[4]

The Federal Constitutional issues herein were raised initially in the Petitioners' Motion for Rehearing. (A. 121a). The issues were not raised previously because the parties had agreed that the independent standard of review applied; and, the Alaska Court's conduct surprised everyone.

The controlling authority condemning a hearing process where the adjudicator has organizational responsibility which conflicts with the interest of a litigant is *Ward v. Monroeville*, 409 U.S. 57 (1972). There, an Ohio statute authorized the mayor to adjudicate traffic offenses. A major portion of the village's income was derived from the fines, fees, and costs imposed in the mayor's court. This Court cited *Tumey v. Ohio*, 273 U.S. 510 (1927) and repeated its test, "whether the mayor's situation is one 'which would offer a possible temptation to the average man as a judge to forget the burden of proof required to convict the defendant, or which might lead him not to hold the balance nice, clear and true between the state and the accused ...'" (409 U.S. at 60) and found a violation of due process.

Similarly, Alaska creates an incentive for the Commissioner to find against the taxpayer. The DOR Commissioner's principal statutory responsibilities are to collect taxes.[5] Since his decisions cannot be overturned if he provides a "reasonable basis," even if the reviewing court is convinced he is wrong, the process is inherently

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[4] The Alaska Court found "Parsons provided engineering, design and agency procurement services from its home office in California." (A. 4a).

[5] AS §43.05.150, AS §43.05.010, AS §44.25.020, Alaska Admin. Code tit. 15, §05.035.

prejudicial and all but mandates a biased decision unless there is *de novo* review of at least the nontax legal decisions.

The Alaska tax procedure is distinguishable from the procedure in *Withrow v. Larkin*, 421 U.S. 35 (1975). *Withrow* stands for the rule that the combination of investigative and adjudicative functions in an administrative agency does not, without more powers vested in the agency, create an unconstitutional risk of bias in an administrative adjudication. *Withrow* recognizes, however, that such a risk may be shown in special circumstances.

The Court had before it a Wisconsin statute empowering a physician's examining board to investigate whether probable cause existed to institute criminal action for revocation of a physician's license and to suspend the license temporarily upon a determination that the licensee was guilty of a violation. The Court pointed out that a finding of probable cause did not necessarily prejudice the board on a later determination of guilt. The Court also observed that the board had organized itself internally to minimize the risk arising from combining investigation and adjudication. Thus, the Court held that the facts shown did not meet the test of unconstitutional risk of bias in administrative adjudication, which was stated as follows:

> It must overcome a presumption of honesty and integrity in those serving as adjudicators; and it must convince that, under a realistic appraisal of psychological tendencies and human weaknesses, conferring investigative and adjudicative powers on the same individuals poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented. *Withrow*, 421 U.S. at 54.

The Court was careful to note that its holding did not "preclude a court from determining from the special facts

and circumstances present in the case before it that the risk of unfairness is intolerably high." *Id.* Such is the case here.

The *Withrow* case is distinguished from this case in two important ways. In *Withrow*, the board possessed only investigative and adjudicative powers and did not act as prosecutor or advocate. Further, the board lacked any economic incentive or statutory mandate to find against the doctors it regulated. In sharp contrast, the Commissioner is statutorily charged with both the obligation to supply money for state operations and to make the final decision in taxpayer disputes. If the Commissioner does not collect enough taxes, he or she has to justify the failure. This procedure in itself creates an intolerable risk of unfairness. *See, e.g., Huber Pontiac, Inc. v. Allphin*, 431 F. Supp. 1168 (S.D. Ill. 1977), *vacated on other grounds sub nom. Huber Pontiac, Inc. v. Whitler*, 585 F.2d 817 (7th Cir. 1978). Had the *Withrow* board exercised similar powers, unquestionably this Court would have found a constitutional violation to have occurred.

Moreover, and overriding, the Alaska Court will reverse the DOR's decision only if the DOR lacks a reasonable basis for the decision. Under such circumstances, "under a realistic appraisal of psychological tendencies and human weaknesses," the DOR system of reviewing cases "poses such a risk of actual bias or prejudgment that the practice must be forbidden if the guarantee of due process is to be adequately implemented." *See Withrow*, 421 U.S. at 47.

A similar but less biased procedure was condemned in *Huber Pontiac, Inc. v. Allphin*, 431 F. Supp. 1168. In that case, an automobile dealer challenged the process by which Illinois heard tax disputes. There, the hearing officer presided, presented the Illinois Department of Revenue's case, cross-examined witnesses, ruled on objections and on admissibility of evidence (although the evidence was placed

on the record so that the correctness of the ruling could be determined on appeal), and, when the hearing was completed, prepared a report, full record of the hearing and recommendations for the department's decision. Under those circumstances, the district court held that the combination of adversarial and adjudicative functions denied due process.

Engineer presented overwhelming evidence that it acted as its client's agent. Despite this overwhelming evidence and the DOR's willingness to stipulate to that evidence, the Alaska Court ignored it and ruled that Engineer sold tangible personal property even though there was no reasonable basis for this contention. The Alaska Court refused to even discuss the critical facts in its decision. This practice which evidences systemic bias, culminating with the standard of review, must be forbidden if the guarantee of due process is to mean anything.

III. THE ALASKA COURT BASED ITS DECISION ON AN UNTENABLE INTERPRETATION OF AGENCY LAW IN AN ATTEMPT TO DISCRIMINATE AGAINST INTERSTATE COMMERCE

For a century or more this Court has been adamant that any state ground must be a tenable ground before this Court will refrain from protecting a litigant's federal rights. The state ground must have fair and substantial support, and local practice may not impose unreasonable obstacles to the assertion of federal rights. *James v. Kentucky*, 466 U.S. 341, 348-49 (1984).

Several states have been furtively seeking ways to discriminate against constitutionally protected classes such as out-of-state people and businesses and, having suffered defeat in this Court time and time again on the federal issues, have turned to fabricating state grounds to hide behind when they discriminate against federally protected

interests. Such is the practical effect here. Presumably, the Alaska Court recognizes that it is forbidden to discriminate against or unreasonably burden interstate commerce (or discriminate based on the length of residence, *Zobel v. Williams*, 457 U.S. 55 (1982)). However, that is exactly what the Alaska Court's decision is doing here. It has masked its opinion with new and unsupported agency rules which apparently apply only to out-of-state persons (or, perhaps, only to out-of-state taxpayers whose taxes would be increased by these rules): that an agent cannot have bare legal title to a bank account or other property, that agency has to be disclosed, that an independent contractor cannot be an agent, that an agent cannot be responsible for its own employees, and that if a party ever sells to another person, that party cannot later become an agent for its client.

None of these grounds is supportable under Alaska law or any other law, and the Alaska Court made no tenable attempt to provide such support. Instead, it issued a "nonopinion," hiding from the public the damage it inflicted on interstate commercial interests.

IV. ALASKA'S CHOICE OF ALASKA LAW AND REJECTION OF CALIFORNIA LAW ON THE ISSUE OF AGENCY UNDULY BURDEN INTERSTATE COMMERCE AND DENY ENGINEER DUE PROCESS OF LAW

Even in the absence of an express choice of law by the contracting parties, fundamental fairness would have required the Alaska court to apply California law on the question of agency. The Restatement (Second) of Conflict of Laws, for example, attempts to identify the state with the most significant relationship with respect to the issue in question, or when appropriate, the contract as a whole, by looking to factual contacts that the transaction has with the concerned states. The relevant contacts to be taken into

account under Restatement §188 include: (1) the place of contracting; (2) the place of negotiation of the contract; (3) the place of performance; (4) the location of the subject matter of the contract; and (5) the domicile, residence, nationality, place of incorporation and place of business of the parties.

The creation of *ad hoc* Alaska law on the question of agency was unfair because Alaska lacked significant factual contacts with the purchasing agency function, and the contracting parties reasonably could not have anticipated the application of Alaska law to their relationship. More important, and overriding, Alaska does not have a *real* interest in applying its law on the issue of agency. Alaska's tax law would reach the sellers of tangible personal property delivered to Alaska if Engineer were determined to have been a purchasing agent; a decision in favor of petitioners merely means Alaska has directed its assessment powers at the wrong *taxpayer*.

The Due Process Clause of the Constitution imposes limits on the power of a forum state's courts to denigrate sister state law in favor of forum law. The decision of a state court to apply its own law will be found unconstitutional on the grounds of due process when (1) that state has no interest in applying its law on the point in issue, *or* (2) that state does not have sufficient factual contacts with the underlying transaction. Under either of these two approaches, Alaska's choice of Alaska law denies petitioners due process.

The Court's present approach to constitutional limitations on choice of law is reflected in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). In *Shutts*, this Court invalidated on due process grounds a state's application of its own law to govern *all* the claims in a class action arising from several states.

Three royalty owners brought a class action in a Kansas state court, on behalf of royalty owners living in several states, seeking to recover interest on suspended royalty payments on properties in several states. The defendant oil company had delayed payment of a portion of the royalty payments applicable to a price increase which had not yet been approved by government authorities. The Kansas courts applied Kansas substantive law to *all* of the claims in the case; however, it was not clear that the defendant would be liable for interest on the suspended royalty payments under the laws of all of the other states, and the statutory interest rate in some of these states was less than the Kansas interest rate.

This Court held that the application of Kansas law to determine all of the claims was "sufficiently arbitrary and unfair as to exceed constitutional limits." *Id.* at 822. Kansas' status as the forum of this class action, standing alone, did not make it reasonable for Kansas to apply its substantive law to determine the defendant's liability to pay interest where the royalty owners and the land under lease were not in Kansas. These parties could not have foreseen the application of Kansas law to govern their rights under the leases. *Shutts* illustrates the situation in which the application of the forum's law would be *both* arbitrary and fundamentally unfair, and thus, an unconstitutional denial of due process. *Accord, Home Ins. Co. v. Dick*, 281 U.S. 397 (1930).

Similarly, it is inescapable that the choice of law determination of Alaska affects interstate commerce in a persistent, subtle and unconstitutional way. Such action tends to balkanize the American economy; and, therefore, that choice must give way to the overriding United States policy of noninterference in matters affecting interstate commerce. *Southern Pacific Co. v. Arizona*, 325 U.S. 761 (1945). It is well established that a state law that has the

practical effect of regulating commerce occurring wholly outside that state's borders is invalid under the Commerce Clause. *See, e.g., Healy v. Beer Institute*, 491 U.S. 324 (1989) (beer price statute violates Commerce Clause).

To have thriving, efficient interstate commerce, we need a clear rule that will unambiguously resolve recurring cases, and the likely territorial conception of the average citizen, regarding agency relationships. No state has a substantial enough interest in regulating the manner in which property acquired outside its borders is purchased so as to override an express choice of the law of the situs in which the property is acquired and the situs in which the governing contract is negotiated, signed and in relevant part performed. The justification for recognizing the express choice of law here is that the primary purpose of contract law--to protect the legitimate expectations of the parties and to ensure stability in commercial transactions--will be best served in the interstate context by allowing the parties to choose in advance the law that will govern their rights and liabilities under the contract. Indeed, the Restatement Second takes the position that an express choice of law should be recognized as to matters of validity and enforceability, displacing otherwise applicable law, unless there are cogent reasons for not recognizing the choice in a particular case. Restatement (Second) of Conflict of Laws, §187(1). If Alaska may regulate the terms of a California purchasing agency, so may all the other states, and they need not be uniform in their requirements. The practical effect of such regulation is to control agency contracts beyond the boundary of the state because of the necessity of complying with each state's law so as not to become inadvertently liable as a principal in some state in which the value of one's services or intangibles are utilized.

There should be no doubt that Alaska's definition of agency imposes, in violation of the Constitution, a serious

burden on the interstate commerce conducted by petitioners. Ever since *Gibbons v. Ogden*, 22 U.S. 1 (9 Wheat.) (1824), the states have not been deemed to have authority to impede substantially the free flow of commerce:

> For a hundred years it has been accepted constitutional doctrine that the commerce clause, without the aid of Congressional legislation, thus affords some protection from state legislation inimical to the national commerce, and that in such cases, where Congress has not acted, this Court, and not the state legislature, is under the commerce clause the final arbiter. *Southern Pacific v. Arizona*, 325 U.S. at 769.

There is no difference between state legislation inimical to the free flow of commerce and the Alaska Court's *ad hoc* and arbitrary mischaracterization of an agency relationship which contradicts the relationship expressly and permissibly established by the California Petitioners and their California client. As this Court recognized in *Erie Railroad v. Tompkins*, 304 U.S. 64, 78 (1938), it is of no federal concern whether state law is embodied in statutes or cases; each is of equal authority. In other words, the state must give due process of law to nonresidents, and the form of the sister state's law is irrelevant.

Alaska may not, consistent with the Commerce Clause (or due process), burden the terms of a contract the object of which is the transportation of articles of commerce from one state to another. *Richmond & A. R. Co. v. R. A. Patterson Tobacco Co.*, 169 U.S. 311 (1898); *Central Georgia Railway Company v. Murphey*, 196 U.S. 194 (1905).

V. THERE IS AN URGENT NEED TO CLARIFY THE RULES WHICH APPLY TO CHOICE-OF-LAW DECISIONS IN AN INTERSTATE COMMERCE CONTEXT

Where issues have a dramatic effect on interstate commerce, as here, the need to identify the law requires a minimum degree of certitude. The decision in *Shutts* was based on an earlier test set forth in *Allstate Insurance Co. v. Hague*, 449 U.S. 302 (1981). There, the Court upheld Minnesota's application of its own law to invalidate a clause in an insurance policy issued in Wisconsin to a Wisconsin resident killed in a Wisconsin accident. The plurality opinion of Justice Brennan, joined in by Justices White, Marshall, and Blackmun, treated the test under due process to be coextensive with the test under full faith and credit and stated that test as follows:

> [F]or a state's substantive law to be selected in a constitutionally permissible manner, that state must have a significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary or fundamentally unfair.

The contacts relied upon were seemingly irrelevant to the legal issues in the case: the decedent's widow moved to Minnesota (after the claim arose), the insurer did business in Minnesota (and every other state), and decedent had worked in Minnesota (but his death was not job related). Apparently the plurality felt that vindication of the rights of a Minnesota employee was an important state concern, which when combined with other Minnesota contacts, rendered the state's choice of law not unconstitutional. It has been opined that, "*Hague* may mean that there are no limits whatever on a state's power to apply its own law to benefit a resident litigant." Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 Colum. L. Rev. 249

(1992). Surely, this is incorrect. People cannot know the law unless they know which law to learn. In the circumstances presented here, where the legal issue concerns the construction and interpretation of a purchasing agency contract between California residents, negotiated and signed in California, and performed in relevant part wholly outside of the forum state, it unduly burdens interstate commerce to dispense with all territorial considerations in determining choice of law and to choose the law of a forum with whom a party has some significant contacts--but no contact relating to the precise legal issue upon which judgment depends.

If Alaska wants a custom-made agency rule to control for purposes of Alaska tax law, it may enact it as part of the governing tax statute; Alaska, however, may not create rules on an *ad hoc* basis to sandbag sister states' residents performing contracts in interstate commerce. When the Alaska Court adopts such *ad hoc* agency rules, the unfair surprise imposed on out-of-state taxpayers violates elemental principles of due process; and the emanations of uncertain rules impermissibly burden interstate commerce.

CONCLUSION

An adjudicative mechanism which favors local litigants and local law over residents and laws of other states is unconstitutional. Courts owe equal concern and equal respect to residents of other states. Courts owe equal respect to sister state law. The decision in this case is evasive and lacks any substantial or adequate state grounds in its support--even worse, however, is the systemic bias which perpetuated the decision, created by an adjudicative mechanism in which a court decision in favor of a nonresident may be disregarded when the head of the administrative agency against which it was decided so rules.

For the reasons set forth herein, The Parsons Corporation and The Ralph M. Parsons Company respectfully request that the decision of the Alaska Court be reversed and that the well-reasoned decision of the Lower Court be followed.

Respectfully submitted,

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Supreme Court, U.S.
FILED
MAR 31 1993
OFFICE OF THE CLERK

92-1600
No.

In The
The Supreme Court of the United States
October Term, 1992

THE PARSONS CORPORATION AND
THE RALPH M. PARSONS COMPANY,
Petitioners,

v.

STATE OF ALASKA, DEPARTMENT OF REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ALASKA

APPENDICES TO
PETITION FOR WRIT OF CERTIORARI

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APPENDIX A

THE SUPREME COURT OF THE STATE OF ALASKA

STATE OF ALASKA, DEPARTMENT OF REVENUE, Appellant, v. THE PARSONS CORPORATION and THE RALPH M. PARSONS COMPANY, Appellees.	)	File No. S-4137 3AN-88-7899 CI OPINION [No. 3910 - December 31, 1992]

Appeal from the Superior Court of the State of Alaska, Third Judicial District, Anchorage, Roy H. Madsen, Judge.

Appearances: Marilyn May, Teresa Williams, David T. Leblond, Assistant Attorneys General, Anchorage, Charles E. Cole, Attorney General, Juneau, for Appellant. Lance B. Gordon, Patrick G. Woosley, Pasadena, California, David G. Shaftel, Anchorage, for Appellees.

Before: Rabinowitz, Chief Justice, Burke, Matthews, Compton and Moore, Justices.

BURKE, Justice.

The Alaska Department of Revenue ("DOR") appeals the superior court's reversal of DOR's July 5, 1988, administrative decision affirming the audit division's assessment of corporate income taxes against the Parsons Corporation and The Ralph M. Parsons Company ("Parsons") for tax years 1977 through 1981. At issue is the proper allocation of revenue derived from contracts to construct oil and gas facilities at Prudhoe Bay under the three-factor formula of the Multistate Tax Compact, AS 43.19.01043.19.050.

In computing the "sales" factor, Parsons excluded from the numerator revenues which it attributed to services performed outside the State of Alaska. DOR determined that the revenues were derived not from services alone but from transactions involving the sale of tangible personal property delivered inside the State of Alaska, and therefore included the revenues in the Alaska numerator of the sales factor. After a formal hearing, DOR affirmed the audit division's assessment, finding that Parsons' contractual activities on the North Slope constituted a sale of tangible personal property. The trial court reversed DOR's decision. We reverse the trial court and affirm DOR's administrative decision.

I. FACTS

Parsons is a multinational corporation providing design, engineering, procurement, and construction services to private and governmental clients throughout the world. In the 1970's and early 1980's, Parsons was engaged in extensive, multiyear projects involving the oil and gas production facilities at Prudhoe Bay.

Beginning in 1971, Parsons contracted with Atlantic Richfield Company and ARCO Oil and Gas Company (collectively "ARCO") to design and construct oil and gas field facilities for Prudhoe Bay. Parsons and ARCO renegotiated their contractual relationship a number of

times, but they stipulated that only three of these contracts were at issue for the tax years in question: contract 4834, dated January 28, 1971; contract 5600, dated October 11, 1978; and contract 6000, dated March 24, 1979. The contracts are cost-plus-fixed-fee contracts utilizing a zero balance bank account mechanism.

Contract 4834 states that Parsons agrees to manufacture, fabricate, deliver, and sell at Prudhoe Bay modules and other equipment described in the contract documents. Parsons is to perform all work under the contract as an independent contractor and not as an agent. Parsons is to be paid for the sale of modules under the contract. Title to property, including modules, materials, and equipment for the project acquired or manufactured by Parsons vests in Parsons. Title only passes to ARCO when the modules and other equipment are completed, delivered, and accepted at Prudhoe Bay. Parsons warrants that the modules and equipment free of defects in material and workmanship.

Contract 5600, in revised form, incorporates the same job instructions as contract 4834. Parsons is to construct North Slope oil field facilities in a series of units called modules. Title to property acquired or manufactured by Parsons will initially vest in Parsons until title passes upon delivery.

Contract 6000 is in a form similar to contract 5600. It is for the construction and delivery of oil field modules. Key elements of the design concepts under the contract include constructing the facilities in modules in the Lower 48 to minimize Prudhoe Bay construction; limiting the size of the modules to stay within the limits of current crawler/transporter technology; fabricating the modules on the west coast for direct access to ocean-going barges; scheduling the construction in annual increments to meet sealift dates; offloading the modules onto gravel causeways at Prudhoe Bay; supporting them on pilings anchored in the

permafrost; and interconnecting the modules to minimize personnel exposure to the Arctic environment.

Parsons performed under these contracts in several states outside of Alaska. Parsons provided engineering, design, and agency procurement services from its home office in California. Parsons designed the facilities in modular sections which were partially assembled in Washington and Oregon, where Parsons provided construction management services. The modules were then barged to Prudhoe Bay where they were hauled into place by huge tractors. Some of the modules fabricated in Tacoma, Washington, were up to eight stories high.

II. PROCEEDINGS

In filing Alaska corporation income tax returns, Parsons used the three-factor apportionment method to determine its Alaska taxable income. In general, Parsons attributed revenues from the ARCO contracts to work performed outside of Alaska and therefore excluded them from its Alaska sales numerator. DOR's audit division, however, attributed these revenues to the Alaska numerator, and accordingly adjusted Parsons' Alaska sales numerator and total tax liability.

Parsons appealed the audit division's assessment to a formal hearing after the audit division issued an informal conference decision affirming the audit assessment for the tax years 1977, 1978, and 1979. The formal hearing affirmed the assessment, and Parsons paid the additional tax and interest due of $73,405.90 on October 28, 1983. Parsons appealed this decision to the superior court but later stipulated with DOR to remand the appeal, and the case was dismissed without prejudice.

On June 11, 1984, the audit division issued another notice of assessment to Parsons for the tax years 1980 and 1981. The audit adjustments resulted in additional tax

liability for Parsons of $309,682 for 1980, and $203,812 for 1981. Parsons appealed these assessments. The 1980 and 1981 issues were consolidated by agreement with the tax years 1977, 1978, and 1979. The audit division's assessments were affirmed at both an informal conference and subsequent formal hearing. DOR issued Decision No. 88-67 on July 5, 1988.

Parsons appealed to the superior court on August 4, 1988. On July 3, 1990, the superior court issued a memorandum opinion and decision reversing DOR's Decision No. 88-67. Judge Madsen held that Parsons sold services to ARCO in contracts 5600 and 6000 and rendered services through a separate income producing activity under contract 4834.

The superior court awarded Parsons attorney's fees of $25,000 on September 20, 1990. DOR appealed the superior court's memorandum opinion and decision on July 30, 1990, and later amended its appeal to include an appeal of the superior court's order awarding attorney's fees.

III. DISCUSSION

A. Standard of Review

We summarized our approach toward reviewing administrative decisions in *Handley v. State*, 838 P.2d 1231, 1233 (Alaska 1992):

> We will independently review the merits of an administrative determination. No deference is given to the superior court's decision when that court acts as an intermediate court of appeal.
>
> We have recognized four principal standards of review of administrative decisions. The 'substantial evidence' test is used for questions of fact. The 'reasonable basis' test is used for questions of law involving agency expertise. The 'substitution of judgment' test is used for questions of law where no

> expertise is involved. The 'reasonable and not arbitrary' test is used for review of administrative regulations. (citation omitted).

In the present case, the reasonable basis test applies. The facts are complex. Interpreting the Multistate Tax Compact ("Compact") depends upon the "'particularized experience and knowledge of the administrative personnel'." *Gulf Oil Corp. v. State. Dep't of Revenue*, 755 P.2d 372, 378 n.19 (Alaska 1988) (quoting *Kelly v. Zamarello*, 486 P.2d 906, 916 (Alaska 1971)). We are satisfied that the reasonable basis test is appropriate because this case "requires resolution of policy questions which lie within the agency's area of expertise and are inseparable from the facts underlying the agency's decision." *Earth Resources v. State. Dep't of Revenue*, 665 P.2d 960, 964 (Alaska 1983). Therefore, we will not reverse DOR's decision if there is a reasonable basis to support it.

B. The contracts between Parsons and ARCO were for the sale of tangible personal property delivered to a purchaser in Alaska for purposes of the Compact, AS 43.19.010, Art. IV.

One of the purposes of the Compact is to avoid duplicative taxation of business entities which do business in more than one state or nation. AS 43.19.010, Art. I. The Compact sets out a three factor formula to measure the business income attributable to each state. AS 43.19.010, Art. IV(9). The three factors are property, payroll, and sales. The sales factor, the relevant factor in this case, is the ratio of the taxpayer's sales made in the taxing state during the tax period and the total sales of the taxpayer everywhere during the same period. AS 43.19.010, Art. IV(15). The property and payroll factors are similarly determined. The business's taxable income that is apportioned to the taxing state is then determined by

multiplying the business income by a fraction derived from these three factors.[1]

Using the Uniform Division of Income for Tax Purposes Act approach, the Compact divides sales revenues into two categories and applies different sourcing rules to each: (1) revenue from sales of tangible personal property is sourced to the place of delivery and (2) revenue from sales of services is sourced to the place of performance.[2] The income tax results in this case depend upon the classification of Parsons' business activity. If Parsons acted as a manufacturer and seller of oil field modules its revenues were for the "sale of tangible personal property." If Parsons acted as a contractor who procured materials as a purchasing agent and was paid for skills and services provided, its revenues were from sales "other than sales of tangible personal property." AS 43.19.010, Art. IV.

In Decision No. 88-67, DOR determined that Parsons' "engineering, construction management, and procurement

---

[1] The numerator of the fraction is the property factor plus the payroll factor plus the sales factor; the denominator is three. AS 43.19.010, Art. IV(9).

[2] AS 43.19.010, Art. IV. Division of Income.

. . . .

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser . . . within this state.

. . . .

17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

services were performed in order to sell tangible personal property to a customer in Alaska." It therefore affirmed the audit division's assessments. In so doing, DOR properly rejected Parsons' arguments that Parsons was only acting as ARCO's agent[3], and that Parsons' California home office

---

[3] In determining that Parson's was not ARCO's agent, DOR carefully examined the facts of the present case, and compared these to relevant authority. After reviewing the record, and using our independent judgment, we agree with DOR's decision on this issue. As DOR notes,

> The Taxpayer retain[ed] legal title to the procured materials and equipment until it was delivered to Prudhoe Bay. It was responsible for insuring its own employees and certain other items, and was liable for any personal injury, death or damage to property arising out of the Taxpayer's work. The Taxpayer warranted its work. It was responsible for hiring employees and making payments for purchases. It obtained workers' compensation insurance, employers' liability insurance, comprehensive bodily injury, personal injury and property damage liability insurance, and was obligated to require its subcontractors to carry these same type[s] of insurance coverages. It also was [] responsible for all taxes.
>
> . . . .
>
> [A]ll of the contracts state that the Taxpayer was an independent contractor. Contract 4834 additionally specifies that the Taxpayer is not an agent or employee of ARCO. As the Audit Division points out, at no [time] in this appeal has any evidence been presented by ARCO or on its behalf that it intended the Taxpayer to serve as its agent. Rather, the contract provisions state the contrary. . .
>
> . . . .
>
> [Finally,] [t]he purchase order forms do not convey an agency relationship. The form is clearly a form of the Taxpayer, listing the Taxpayer's name, its logo and addresses at the top of the form. Additionally, throughout the form, reference is made to the Taxpayer. The form states that the item is to be shipped to the Taxpayer, but does list the address as "c/o Atlantic Richfield Company." The Taxpayer has not stated, nor is it likely to

engineering services constituted a separate income producing activity.

The relevant statute and regulations support DOR's decision. The Compact considers sales of tangible personal property to be in Alaska if "the property is delivered or shipped to a purchaser . . . within this state regardless of the f.o.b. point or other conditions of the sale." AS 43.19.010, Art. IV, ¶16(a). DOR has promulgated rules pursuant to the Compact to help determine "sales" in various situations. Thus, for example, in the case of "cost-plus-fixed-fee contracts," such as the contracts in the present case, "'sales' includes the entire reimbursed cost, plus the fee." 15 AAC 19.251(a)(2).

For the sales factor, DOR properly attributed Parsons' revenues to sales of tangible personal property made in Alaska. Regardless of the f.o.b. point and other conditions of the contracts, modules were shipped to a purchaser in Alaska. AS 43.19.010, Art. IV, ¶16(a). Because the recipient was located in Alaska, the modules are considered to be "delivered" here, even though they were ordered from outside the state. See 15 AAC 19.281(b). Furthermore, the sales properly included the entire reimbursed cost, plus the fee. 15 AAC 19.251(a)(2).

We reject Parsons' argument that its revenues were derived from "professional services." The relevant sales factor regulation, when referring to taxpayers engaged in providing services, lists such activities as "the operation of

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> occur, that if a non-reimbursable item is purchased using the purchase order forms that a vendor could collect against ARCO. [sic]

(Citations omitted). Given these facts, it is easy for us to conclude that Parsons should not be considered ARCO's agent for Alaska income tax purposes.

an advertising agency, or the performance of equipment service contracts, [or] research and development contracts." 15 AAC 19.251(a)(3). Parsons' activities do not fit into either the specific activities listed or the general class of activities the list is meant to illuminate.

The regulation for sales other than sales of tangible personal property lists such business activities as rendering personal services; selling, renting, or leasing real property; renting or leasing tangible personal property; and selling intangible personal property. 15 AAC 19.301(b)(1-4). Parsons did not do any of these things under the ARCO contracts.

In Decision 88-67, DOR concluded,

> It is clear that the Taxpayer's contracts here required the Taxpayer to perform services and procure the materials and equipment necessary to produce the modules. In fact, in the later contracts, the procurement of materials and equipment for ARCO was so integrated into the contracts that no separate phase of the contract exists outlining the sale and transfer of the property. The modules that incorporated the procured property were more than just "incidental" to the services rendered. It is clear that the contracts required more than just rendering service.

We agree. We are satisfied that the record contains a reasonable basis to support DOR's Decision 88-67.[4]

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[4] The cases Parsons relies on to argue that there was no "sale" here are distinguishable. In *Mark IV Metal Products*, CCH Cal Rptr. para. 400-268 (Cal. St. Bd. Eq. 1982), the owner sent unfinished metal to the contractor, who fabricated it into seat parts which the contractor shipped back to the owner, who then incorporated them into metal seats for sale to the owner's customers. In *Lone Star Steel v. Dolan*, 668 P.2d 916 (Colo. 1983), the issue was whether pipe was sold in state or

It is a fair result to attribute Parsons' sales to Alaska. The North Slope contracts are important to Parsons. Parsons has described itself as the "unrivalled leader in the modularization of production and process facilities for use" on the North Slope. Thus, even though most of Parsons' activities are conducted outside of Alaska, it is perfectly appropriate to attribute all of its revenues to Alaska, for sales factor purposes. *See Sjong v. State. Dep't of Revenue*, 622 P.2d 967 (Alaska 1981). Failure to attribute sales to the state in which they are made "would greatly under-represent the extent of the taxpayer's activities within the state." Id. at 978.

IV. CONCLUSION

We REVERSE the superior court's memorandum opinion and decision and AFFIRM DOR's Decision No. 88-67. We also VACATE the superior court's attorney's fees award.

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out of state when it was first delivered by the manufacturer to an in state business which applied coating and wrapping, before the pipe was shipped to the out of state purchaser.

Parsons' "services" were not analogous to the services of coating and wrapping the pipe in *Lone Star*, or the fabricating of metal seat parts in *Mark IV*. Parsons manufactured the modules, as ARCO's contractor, and delivered them to ARCO in Alaska. Therefore, the gross receipts Parsons derived from that delivery are taxable in Alaska. Alaska Statute 43.19.010 Art. IV, paragraph 16(a) is designed to cover transactions, such as the one in the present case, which are "not traditionally viewed as sales." *See Coulter Electronics v. Department of Revenue*, 365 So. 2d 806, 808 (Fla. App. 1978). The relevant inquiry, which we engage in above, is whether tangible personal property is delivered in this state.

APPENDIX B

IN THE SUPREME COURT OF THE STATE OF ALASKA

STATE OF ALASKA,	)	
DEPARTMENT	)	Supreme Court
OF REVENUE,	)	No. S-4137
Appellant,	)	ORDER
v.	)	
	)	
THE PARSONS CORPORATION	)	
and THE RALPH M.	)	
PARSONS COMPANY,	)	
Appellees.	)	
	)	

Superior Court No. 3AN-88-7899 Civil

Before: Moore, Chief Justice, Rabinowitz, Burke, Matthews, and Compton, Justices.

On consideration of the petition for rehearing, filed on November 30, 1992,

IT IS ORDERED:

1. Opinion No. 3899, published November 20, 1992, is WITHDRAWN.

2. Opinion No. 3910 is issued on this date in itstcwy place.

3. The petition for rehearing is granted to the extent that the opinion is modified; otherwise, it is DENIED.

Entered by direction of the court at Anchorage, Alaska on December 31, 1992.

CLERK OF THE SUPREME COURT

/s/ Jan Hansen

Jan Hansen

APPENDIX C

IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

THIRD JUDICIAL DISTRICT AT KODIAK

THE PARSONS	)	(Stamped)
CORPORATION AND	)	Filed in the Trial Courts
THE RALPH M.	)	STATE OF ALASKA,
PARSONS COMPANY,	)	THIRD DISTRICT
Appellant,	)	APPEALS DIVISION
v.	)	July 3, 1990
STATE OF ALASKA,	)	Clerk of the Trial Courts
DEPARTMENT OF	)	By _____ Deputy
REVENUE,	)	
Appellee.	)	No. 3AN-88-7899 Civil

MEMORANDUM OPINION AND DECISION

I. INTRODUCTION

This appeal arises from a decision of the Alaska Department of Revenue issued on July 5, 1988, affirming the Audit Division's assessment of corporate income taxes against the appellant for tax years 1977 through 1981. At issue is the proper allocation of revenue derived from contracts to construct oil and gas facilities at Prudhoe Bay under the three-factor formula of the Multistate Tax Compact, Alaska Statutes 43.19. In computing the sales factor, one of the three factors, the appellant excluded from the numerator those revenues it attributes to services

performed outside the State of Alaska. The department determined that the transaction was a sale of tangible personal goods delivered inside the State of Alaska, and included in the Alaska numerator the gross revenues derived from the contracts.

II. FACTS AND PROCEEDINGS

The Parsons Corporation and the Ralph M. Parson's Company ("Parsons") is a multinational corporation providing design, engineering, procurement and construction services to private and governmental clients for a variety of petroleum and chemical, mining and metallurgical, transportation, eviron-mental, and nuclear power projects throughout the world. R. File 10 at 5. In 1971, Parsons contracted with Atlantic Richfield Company and ARCO Oil and Gas Company (collectively "ARCO") to design, construct and manage the oil and gas separation and gathering facilities in Prudhoe Bay, Alaska. ARCO and Parsons renegotiated their contractual relation-ship many times, but the parties have stipulated that only three contracts are at issue for the tax years in question: Contract 4834 signed January 28, 1971; Contract 5600 signed October 11, 1978, and Contract 6000 signed March 24, 1979. R. File 1 at 5.

Parsons performed under the contracts in several states outside of Alaska. From its home office in California, Parson's performed design, engineering and architectural services. Parsons designed the facilities in modular sections, which were partially assembled in Washington and Oregon, then barged to Prudhoe Bay where they were hauled into place by huge tractors. Some of the modules fabricated in Tacoma, Washington, were up to eight stories high and were fairly complete buildings.

On October 7, 1983, the department adopted the decision of a revenue hearing examiner regarding tax years 1977, 1978, and 1979. The hearing examiner found that the

contract included severable phases, some of which address service activities; nevertheless the examiner held that because the contract includes the delivery of tangible personal property inside the state, the entire contract constitutes a single sale within the meaning of the Multistate Tax Compact. R. File 10A at 46.

Parsons thereafter filed a Notice of Appeal with the Superior Court on November 7, 1983. *The Parsons Corp. v. Department of Revenue*, No. 3AN-84-2481 CIV (Alaska Sup. Ct. 1984). The additional tax liability specified in the decision of the hearing examiner in the amount of $73,405.90 had been paid earlier on October 28, 1983.

Parsons and the department agreed to remand the dispute to the department to supplement the record and consider other issues. On August 8, 1984, the Superior Court remanded. During the pendency of the appeal in Superior Court, the Audit Division issued a Notice of Assessment to Parsons on June 11, 1984, which reflected additional tax liabilities for tax years 1980 and 1981. Parsons appealed that assessment administratively. The parties agreed to consolidate the appeal for tax years 1980 and 1981 with the remanded issues for tax years 1977, 1978 and 1979.

The department held a formal hearing on July 25, 1985. The record was closed on December 24, 1987, after the uncontested submission of additional documents by both parties. On July 5, 1988, the department issued Decision No. 88-67 affirming all assessments, holding that Parsons owes $309,682 in taxes for 1980, and $203,812 for 1981, plus interest. R. File 10A at 78. Parsons appeals Decision No. 88-67.

III. ISSUES

Parsons raises three issues in this appeal:

1. Whether the contracts between Parsons and ARCO show that a sale of tangible personal property occurred for

purposes of the Multistate Tax Compact. AS 43.19.010, Art. IV.

2. Whether Parsons acted as the agent for ARCO, requiring that advances of moneys to Parsons as a purchasing agent for materials to construct the modules be excluded from the sales factor of the Multistate Tax Compact. AS 43.19.010.

3. Whether Parson's home office engineering services constitute a separate income producing activity outside of the State of Alaska.

IV. STANDARD OF REVIEW

In Decision No. 88-67, the department relied on the stipulated facts which are before this court in making its findings of fact. R. File 10A at 27. The issues turn not on a question of fact, but on a question of law; therefore, the court will apply the independent judgment standard of review. *Earth Resources Co. v. State, Dep't of Revenue*, 665 P.2d 960, 964-65 (Alaska 1983).

Applying the facts as stipulated, the department held that a sale of tangible personal property occurred within the meaning of the Multistate Tax Compact, R. File 10A at 56, and that Parsons was not acting as the agent of ARCO under Alaska law as applied to income tax cases, R. File 10A at 65. The department further held that where personal services culminate to produce a tangible product delivered to an identified buyer's market place, Alaska law requires allocating the gross receipts to the market state's sales factor. R. File 10A at 71. These issues require a statutory interpretation within the specialized expertise of the department, so that the decision of the department is entitled to some weight. *State, Dep't of Revenue v. Alaska Pulp America*, 674 P.2d 268, 274 (Alaska 1983).

V. DISCUSSION

One of the purposes of the Multistate Tax Compact is to avoid duplicative taxation of business entities which do business in more than one state or nation. AS 43.19.010 Art. I. In order to fairly apportion the income derived from multistate business activities, the compact sets out a three-factor formula to measure the business income attributed to each state. AS 43.19.010 Art. IV § 9. For the first factor, the numerator is the value of the taxpayer's real and tangible personal property owned or rented and used in the taxing state, and the denominator is the total property owned or rented by the business. Likewise, the second factor compares the taxpayer's payroll in the taxing state with its total payroll. And the third factor compares the taxpayer's sales of tangible personal property made in the taxing state to total sales in all states. The fraction derived from these three factors is multiplied by the income of the business to determine the taxable income of the taxing state. Only the sales factor is at issue in this appeal.

A. The Sales Factor

The definition of "sales" in the compact includes both the sale of tangible personal property and sales "other than sales of tangible personal property." AS 43.19.010 Art. IV.17. Sales of services fall into the second category. In holding that Parsons sold tangible personal property to ARCO, the department attributes all revenues derived from these contracts to Alaska as the market state. Under Alaska law, however, construction contractors ordinarily sell services and not tangible personal property. *Department of Rev. v. Debenham Elec. Supply Co.*, 612 P.2d 1001 (Alaska 1980). Typically, a construction contractor procures materials as a purchasing agent and the contractor's fee is for his skill and service. Where the cost of services are an identified part of the costs, only the revenue attributed to those services actually performed in

Alaska would be included in the numerator of the sales factor, not the gross revenues under the contract.

The regulations promulgated by the department to administer the Multistate Tax Compact are not particularly helpful in clarifying whether this rather unique transaction is a sale of tangible personal property or services, but on the whole the regulations tend not to support the department's position. The regulation defining the meaning of "sales" includes a subsection for services:

> In the case of the taxpayer engaged in providing services, such as the operation of an advertising agency, or the performance of equipment service contracts, research and development contracts, "sales" includes the gross receipts from the performance of those services including fees, commissions and similar items.

15 AAC 19.251(3). Gross receipts are attributed to this state, however, only to the extent that those services are performed in this state. 15 AAC 19.301(d)(2)(C). Although the regulations do not list construction contractors specifically as providers of services, the list is not all inclusive; a fair reading of the statute would find that construction contractors best fit under this definition.

The "sales" regulation defining the sale of tangible personal property, on the other hand, provides little support for the department's determination.

> In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of those goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale

> to customers in the ordinary course of its trade or business.

15 AAC 19.251. The word "inventory" and the phrase "held by the taxpayer primarily for sale to customers" shows that the factor for sales of tangible personal property applies generally to the manufacturer, wholesaler or retailer who typically maintains an inventory of goods, not to the construction contractor who designs and builds specialized building modules for assembly on site.

I find these contracts to be more similar to construction contracts, than to contracts for the manufacture and delivery of tangible personal property. The contracting parties' decision to build these facilities in modules which could be assembled at Prudhoe Bay was necessitated because of the adversity of the arctic climate, not for the purposes of altering the nature of the service. I find that a sale of services occurred. Under the Multistate Tax Compact, Article IV.17 a sale of services is a "sale other than a sale of tangible personal property." AS 43.19.010.

B. Parsons Acted as ARCO's Agent

Having determined that under Alaska law a contractor sells services rather than tangible personal property, gross receipts for services performed in Alaska must be included in the sales factor. 15 AAC 19.301(a). Parsons argues that since they acquired materials as ARCO's purchasing agent, the receipts attributed to material procurement should not be included in the sales factor.

The department relies on *Green Const. Co. v. Dep't of Revenue*, 674 P.2d 260 (Alaska 1983) to show that an agency relationship is not established between Parsons and ARCO under Alaska law. In *Green*, the Alaska Supreme Court determined that the legislature intended to tax construction contractors on the total price of a cost-plus contract under the Alaska Business License Act (ABLA),

AS 43.05.230(a). The ABLA included an exemption for agents working for commissions which was at issue in *Green*. The ABLA's gross receipts tax, however, has since been repealed and is not applicable in this appeal. The *Green* court did not consider the Multistate Tax Compact in its decision.

What is critical to this appeal is the *Green* court's test to determine whether an agency relationship exists. In *Green*, Alyeska exercised significant controls over the acquisition of materials and labor by a pipeline contractor, and paid for the materials out of Alyeska's funds. The supreme court found that these controls alone were not enough to establish an agency relationship. The parties do not dispute that ARCO maintained extensive controls over the manufacture of the modules.

The two critical elements in *Green*, however, were whether the parties consented to the agency relationship, and whether the purported principal authorized the agent to create contractual relationships with third parties which bind the principal. *Green*, 674 P. 2d at 265. In *Green*, the parties did not consent to the agency relationship. In fact, they expressly denied any agency relationship: "CONTRACTOR is, and shall be deemed to be, an independent contractor and not the agent or employee of OWNERS or ALYESKA." *Green*." 674 P.2d at 265.

In contrast, Contract 5600 and 6000 between ARCO and Parsons recite duties normally performed by an agent: "CONTRACTOR shall perform SERVICES as specifically authorized by OWNER's designated representative. . . . CONTRACTOR shall procure critical equipment as specified by OWNER . . . [and] perform Final Engineering and total material procurement as specified by OWNER." R. File 1 at 8; R. File 10 at 18. This language, while not expressly consenting to agency, shows by implication that Parson's reasonably could assume that ARCO consented to

the agency relationship. The word "services" used in conjunction with "procure" reflects ARCO's intent to create an agency relationship.

To the second critical element in *Green*, ARCO authorized Parsons to bind ARCO under contract. ARCO required Parsons to make statements, representations and commitments on behalf of ARCO to third party vendors. On ARCO approved purchase orders, ARCO was listed as the "customer," ARCO could inspect materials for ARCO's approval at the vendor's plant, and the vendor indemnified ARCO for all damages and liability arising from the property. R. File 1 at 17-18. ARCO required Parsons to negotiate the best available guarantees on behalf of ARCO, ensure these guarantees and warranties extended to ARCO and assist ARCO in their enforcement. R. File 1 at 7. ARCO controlled whether vendors were included on the procurement list, and excluded vendors were directed to approach ARCO for inclusion. R. File 1 at 13-14. These manifestations to third parties are sufficient to create agency for purposes of liability to third parties: "a principal is subject to liability upon a transaction conducted by his agent, whom he has authorized or apparently authorized to conduct it in the way in which it is conducted, as if he had personally entered into the transaction." Restatement (Second) of Agency (1958) § 140, comment a. The second critical element to establish agency under *Green* is therefore satisfied.

Important to the hearing officer's determination that Parson's was not the agent for ARCO was the fact that Parson's held legal title to the modules until they were delivered at Prudhoe Bay. R. File 10A at 59. The parties, however, have stipulated that although Parson's held legal title to the modules before delivery, ARCO held equitable title. R. File 1 at 10-11. Title to any property held by Parsons under the contract would vest in ARCO without

further consideration upon cancellation or termination of the contract. Moreover, under the contracts, ARCO assumed all risk of loss of the property "at any time, any place, on land, air, or sea." R. File 1 at 11. Had the modules sank in the Bering Sea, ARCO, not Parsons, would have sustained the loss. Under these conditions, legal title in the name of the agent does not alone disprove the agency relationship. Restatement (Second) of Agency (1958) § 14J.

Under Contracts 5600 and 6000, the Court finds that Parsons acted as the purchasing agent for ARCO. Those funds assigned to Parsons by ARCO for the purpose of procuring materials must be deleted from the gross receipts and should be excluded from the sales factor under the Multistate Tax Compact.

C. Separate Income Producing Activities

The department asserts that the language of Contracts 5600 and 6000 redefined the relationship which was established under Contract 4834, solely to avoid tax liability, not for the purpose of changing their relationship. The parties have stipulated, however, that Contract 4834 divided the job into two phases, with three parts for the second phase. R. File 1 at 9. Phase I and the first two parts of Phase II refer to the performance of services. Only in the third part of the second phase, do the contracting parties use the word "sell" when describing the completed modules.

The contracting parties intended to sever the service portion of the contract from the sales portion. If ARCO had elected to end Parsons' participation after design work was completed outside Alaska, Parsons' would have completed an income producing activity without ever having engaged in or performed or delivered services in Alaska. R. File 1 at 19. To the extent that Contract 4834 was defective to accomplish that goal, Contracts 5600 and 6000 made the

relationship clear. The court does not find that contracting parties altered the language merely to defeat tax assessments in Alaska, but to more clearly define their liabilities and duties generally. Because the Multistate Tax Compact provides an apportionment formula to determine tax liability among the various states in which the contracts were performed, Parsons would achieve no overall tax advantage by redrafting the contract to reduce their tax liability in Alaska.

Under Contract 4834, the service phases are separate income-producing activities. Parsons' home office engineering services are included in the sales factor as sales other than the sale of tangible personal property. The gross receipts for those services are included in the numerator of the sales factor as gross receipts to the extent permissible under the regulations.

The regulation states:

> Usually, where services are performed partly within and partly outside of this state the services performed in each state will constitute a separate income-producing activity; in such case, the gross receipts for the performance of services attributable to this state must be measured by the ratio which the time spent in performing those services in this state bears to the total time spent in performing those services everywhere.

15 AAC 19.301(d)(2)(C). Home office engineering services performed in California under Contract 4834, therefore, is a separate income producing activity which was not performed in Alaska. The department must determine the ratio under 15 AAC 19.301(d)(2)(C) for the time spent performing services inside the State of Alaska for each income producing activity under the contracts to determine the proper assessment for tax years 1977-1982.

VI. CONCLUSION

Department of Revenue Decision Number 88-67 is REVERSED and REMANDED for a determination of taxes and interest owed by Parsons, or for a determination that a refund is owed to Parsons, consistent with this decision.

DATED this 3rd day of July, 1990.

/s/ Roy H. Madsen
Roy H. Madsen
Superior Court Judge

APPENDIX D

BEFORE THE DEPARTMENT OF REVENUE
STATE OF ALASKA

IN THE MATTER OF THE PARSONS CORPORATION AND THE RALPH M. PARSONS COMPANY	)	DECISION NO. 88-67
CORPORATION NET INCOME TAX: THE TAXPAYER'S ENGINEERING CONSTRUCTION MANAGEMENT AND PROCUREMENT SERVICES WERE PERFORMED TO SELL TANGIBLE PERSONAL PROPERTY TO CUSTOMERS IN ALASKA, AND WERE NOT SERVICES PERFORMED AS AN AGENT OR TRUSTEE; THE TAXPAYER'S HOME OFFICE ENGINEERING SERVICES PERFORMED OUTSIDE ALASKA ARE NOT SEPARATE INCOME PRODUCING ACTIVITIES FROM THE OTHER CONTRACTED SERVICES TO WARRANT EXCLUDING THEIR VALUES FROM THE NUMERATOR OF THE ALASKA SALES	)	CASELOAD NO. 00036
	)	(Dated)
	)	5 July 1988

FACTOR; THE INCLUSION)
OF GROSS RECEIPTS FROM)
THE PROCUREMENT OF)
MATERIALS AND THE)
HOME OFFICE ENGINEER-)
ING IN THE ALASKA SALES)
FACTOR DOES NOT VIO-)
LATE THE DUE PROCESS)
AND COMMERCE CLAUSES;)
THE TAXPAYER HAS NOT)
DEMONSTRATED THAT AN)
EQUITABLE ADJUSTMENT)
TO ITS ALASKA SALES)
FACTOR IS WARRANTED.)

On July 25, 1985, a hearing was held in the Department of Revenue's Juneau office to determine whether the Alaska corporation income tax assessments for 1977-1981 were properly assessed against The Ralph M. Parsons Company and The Parsons Corporation [Taxpayer]. The record was closed on December 24, 1987 after the uncontested submission of additional documents by both parties.

The hearing was held pursuant to AS 43.05.240 at the request of the Taxpayer. Lance B. Gordon, Assistant Tax Counsel for The Parsons Corporation, was present and represented the Taxpayer. Carl Meyer, Appeals Supervisor, Alaska Department of Revenue, was present and represented the Audit Division.

Theresa Hillhouse, Revenue Hearing Examiner, Alaska Department of Revenue, was appointed by Mary A. Nordale, Commissioner of Revenue, and reappointed by Commissioner Hugh Malone, under the power of delegation in AS 44.17.010, as Hearing Officer in this matter.

Accordingly, the Department of Revenue, through Theresa Hillhouse, having reviewed the record in this case and after due deliberation, makes the following findings, conclusions and decision.

FINDINGS OF FACT

The Taxpayer and the Audit Division entered into a Stipulation of Facts, dated December 4, 1987. These facts are reproduced here verbatim and adopted as Findings of Fact [F.F.] 1-61.

1. On October 7, 1983, the Department of Revenue ("DOR") adopted the decision of Revenue Hearing Examiner Myron W. Klein pertaining to the protest of The Ralph M. Parsons Company and The Parsons Corporation ("Parsons") for tax years 1977, 1978 and 1979. The decision of the Hearing Examiner was that separate phases of a contract which ultimately required the delivery of tangible personal property in Alaska were not separate personal service activities. As such, amounts received for rendition of the personal services that were related to delivery of tangible personal property were includable in Parsons' Alaska sales factor.

2. The additional tax liability specified in the decision of the Hearing Examiner in the amount of $73,405.90 was paid on October 28, 1983.

3. Parsons filed a Notice of Appeal with the Superior Court of the State of Alaska on November 7, 1983. Parsons also designated a record and specified the points to be addressed in the appeal. The Agency Record on Appeal and Counsel list were then filed by the DOR. See Parsons Corporation v. State Department of Revenue, No. 3 AN 84-2481 Civ.

4. Following discussions between the Department of Law, Parsons and the DOR, the parties agreed to a remand of the dispute to the DOR for purposes of supplementing

the record and considering other issues. On August 8, 1984, Judge Karen L. Hunt entered an order for remand and dismissed the appeal without prejudice.

5. During the pendency of the appeal in Superior Court, the DOR's Audit Division ("Audit") issued a Notice of Assessment to Parsons on June 11, 1984 which reflected additional tax liabilities for tax years 1980 and 1981. Parsons timely appealed that assessment on August 2, 1984 and requested an informal conference.

6. The issues for tax years 1980 and 1981 were identical to those addressed in the 1977, 1978 and 1979 tax years.

7. Parsons and the DOR through Audit agreed to a consolidation of all tax years in question for purposes of further administrative review at the informal conference level. This agreement provided that Parsons could protest any adverse informal conference decision for any of the involved years to formal hearing. An adverse formal hearing decision could then be again appealed to Superior Court.

8. An informal conference was conducted in Seattle on December 20, 1984 for tax years 1977-1981. Parsons was represented by Lance B. Gordon, Associate Tax Counsel. Carl A. Meyer, Esq. represented DOR's Audit Division. Mark Graber, Audit Appeals Officer, was also present.

9. Parsons argued that (a) Parsons procured materials as an agent or trustee of ARCO and therefore did not sell property to ARCO as required by AS 43.19.010 Part IV; (b) Parsons performed design and engineering services as a separate income producing activity which is allocable to Parsons' California sales factor; (c) DOR's inclusion of amounts attributable to the materials and out-of-state services in Parsons' Alaska sales factor violates the Due Process and/or Commerce Clauses of the U.S.

Constitution; and, (d) Parsons requested equitable adjustment under AS 43.19.010.

10. Parsons' recalculation of Alaska income tax as adjusted for issues (a) and (b) above are attached in Exhibits 1 and 2. For issue (a) Parsons excluded the value of the materials procured on ARCO's behalf from its sales factor. See Exhibit 1 for the recomputed income tax. For issue (b) Parsons excluded all home office engineering services from the numerator of its Alaska sales factor. See Exhibit 2 for the recomputed income tax.

11. On May 21, 1985 the DOR issued its informal conference decision based on the issues addressed in that meeting. In that decision, the DOR denied each of Parsons' claims.

12. Parsons timely appealed the informal decision of the DOR for a Formal Hearing pursuant to Reg. 15 AAC 05.030.

13. On September 6, 1985 the DOR heard oral arguments for the Formal Hearing. Lance B. Gordon, Associate Tax Counsel, The Parsons Corporation represented the taxpayer; and Carl A. Meyer, Chief of Audit Appeals, Alaska Department of Revenue represented the Department. Theresa Hillhouse, Revenue Chief Hearing Examiner, was Hearing Officer. At that time, the persons above agreed that Parsons and the DOR would submit additional evidence, points and authorities at a later time.

14. Parsons is a multinational corporation providing design, engineering, procurement and construction services to private and governmental clients for a variety of petroleum and chemical, mining and metallurgical, public and civic works, transportation, environmental and power and nuclear projects throughout the world.

15. In performing Parsons' petroleum and chemical projects and its mining and metallurgical projects, Parsons provides a variety of services. On the jobs in question (Job Numbers 4834, 5600, 6000 etc., copies of the contracts for these jobs are attached as part of the record in Exhibits 18, 17, and 15 respectively), Parsons was engaged in providing engineering, procurement, construction management and construction services in connection with several environmental modules for use by the Atlantic Richfield Company and a subsidiary of Standard Oil Company of Ohio (collectively "ARCO"). References to "job" and "contract" are interchangeable.

16. Parsons filed Alaska Corporation Net Income Tax Returns showing a tax liability pursuant to worldwide combination with apportionment of income based on the application of the standard three factor apportionment formula authorized under AS Sec. 43.19.010. For 1977, 1978, 1979 and 1981 Parsons allocated the value of materials purchased on behalf of ARCO in its sales factor numerator to Alaska for Jobs 4834, 5600 and 6000 among other jobs. For these years, Parsons excluded gross receipts attributable to personal services performed outside Alaska from the numerator of its Alaska sales factor. For Parsons' 1980 tax year, receipts attributable to materials were allocated on the basis of labor hours performed in and outside Alaska.

17. DOR reviewed each of the Parsons contracts related to Alaska activities. DOR then characterized the contracts into two groups. The first group were those where Parsons was responsible for procuring materials and equipment necessary to construct facilities to be installed in Alaska. These were design, engineering and construction management related contracts. The second group were those where Parsons was to perform only engineering studies. According to Audit, contracts in the latter group

were not construction or construction management contracts.

18. Following the audit review, Audit proposed to adjust Parsons' Alaska sales factor numerator to include gross revenues related to the performance of engineering services in California with respect to the first group of contracts. Audit viewed these contracts as providing for the sale of tangible personal property in Alaska. The revenues from the second group of contracts were eliminated from the Alaska numerator on the basis that these were service contracts with costs and performances incurred outside Alaska. The contracts within the first group that are in issue here are Contracts 4834, 5600, 6000, 6042, 6095, 6147, 6200 and 7013. Contracts 4834, 5600 and 6000 pertain to most of the years in question. The other contracts pertain to only tax years 1980 and 1981.

19. Audit recomputed income tax liability for the years in question by allocating to Parsons' Alaska sales factor gross receipts from both materials and engineering services on Jobs 4834, 5600, 6000 and the other jobs in the first category.

20. Contract 4834 was signed January 28, 1971, was approximately 18 pages in length and was amended several times until the job was completed during 1979. That job was active from 1971 until about 1979.

21. On October 11, 1978, Parsons and ARCO entered into Contract 5600. This contract was considerably more sophisticated, containing numerous exhibits and schedules and detailed descriptions of the work. This job was active 1978 until 1980.

22. On March 24, 1979 ARCO and Parsons entered into Contract 6000 which is (as are contracts 6042, 6095, 6147, 6200 and 7013) essentially identical in format to contract

5600. Job 6000 was active from 1979 until after audit period.

23. In 1979 Contract 6000 and to a lesser extent contract 5600, became active. By 1980 Job 6000 reflected the controlling contractual document governing the relationship between the parties for performance of engineering, construction management and procurement services by Parsons for ARCO on the North Slope.

24. Contract 5600 is entitled "Agreement for Prudhoe Bay Unit Engineering and Support Services." Contract 6000 is entitled "Agreement ... for Design Engineering and Support." ARCO is referred to as "Owner" and Parsons is referred to as "Contractor" in both contracts. Prefatory language in Contracts 5600 and 6000 provide that "Contractor will provided professional services."

25. Pursuant to both 5600 and 6000, Parsons must submit the names of all key personnel to ARCO; ARCO must approve any changes in these personnel; and, Parsons was required to replace any of its employees if "his work is unsatisfactory to [ARCO]" and "such replacement shall be made on notice."

26. The language of Contracts 5600 and 6000 is substantially different from Contract 4834 in that only design, engineering, procurement and construction support services are contractually provided for under 5600 and 6000.

27. Section 3.0 of Contracts 5600 and 6000 sets forth the "*SCOPE OF ENGINEERING SERVICES*" as falling into "three phases"; preliminary engineering, final engineering, and construction support. Each phase will consist of design, procurement, reporting and planning as specified. In the "construction support" phase Parsons is required to "provide support for subsequent phases of the project (fabrication, logistics, erection, etc.) with home office

engineering and field management or technical support as authorized by OWNER." Section 3.1.3 further defines Parsons' obligation under construction support by providing "CONTRACTOR shall perform any of the following SERVICES at the request of OWNER:"

A. Update any drawings or specifications to accommodate changes made during the construction phase.

B. Incorporate construction phase changes in subsequent increments of related design.

C. Provide inspection or technical support for handling or installation of equipment.

D. Provide facilities or equipment as requested by OWNER to support the construction phase of the project.

E. Provide Field construction management and supervision.

F. Provide Home Office discipline and technical support for field fabrication and erection."

28. Contract 4834 requires the following.

Phase I

Parsons was required to review a feasibility study performed by the Working Interest Owners of oil and gas leases at Prudhoe Bay and to perform additional engineering and cost estimate studies.

Phase II, Part I

Parsons was to complete the construction drawings, cost estimates, schedules, project programs, bidding documents, etc.

Phase II, Part II

Parsons was to perform construction management services including letting contracts and subcontracts, administration, and other matters related to the supply, transport, and installation of the completed projects.

Phase II, Part III

Parsons was to manufacture, fabricate, deliver, and sell to ARCO modules and equipment for use by the working interest owners at Prudhoe Bay.

29. Contract 4834, Article 2, Exhibit C for 6000 and Exhibit B for 5600 provide that for design engineering and procurement services Parsons was "reimbursed for direct cost of wages plus a payroll burden (expressed as percentage of direct payroll worked), and overhead reimbursement (also expressed as a percentage of payroll), and profit (also based on a percentage of payroll). Parsons paid for direct cost of materials, equipment, supplies and subcontract labor and other direct costs out of the zero balance account ("ZBA"). The ZBA was opened in Parsons' name and contained ARCO's address. The contract provided that Parsons was required to use funds deposited in the ZBA only for ARCO approved procurements.

30. No markup or profit of any kind was permitted on, or measured by, the value of materials.

31. Commencing October 6, 1976, for Contracts 4834, and upon signing of Contracts 5600 and 6000, all material was procured using the ZBA. The ZBA operated so that receipt by Republic National Bank of Dallas of a draft triggered a debit to an account in ARCO's name and a credit to the Republic checking account. This method of funding was used to "maximize the efficient use of and visibility of (ARCO) provided funds." See Amendment 3.1 III of Contract 4834; Exhibit D, Contract 6000; Exhibit C, Contract 6000. Further, this provided ARCO with contemporaneous review and approval or control over reimbursable costs. ARCO also exercised control over material procurement as well as controlling the transfer of funds into the Zero Balance Account.

32. Contract 4834, Amendment 4; 6000 XXII, Paragraphs 1 and 2 in Contract 5600 provided that formal title for property procured in Alaska vested in ARCO immediately on acquisition. ARCO arguably retained equitable title to the materials at all times.

33. Formal title to property procured outside Alaska vested in ARCO at the time "the property is received by Parsons in Alaska and delivered to and placed on a project site or a storage or staging area." See Contract 4834, Article XI and Contracts 5600 and 6000, Article XXII.

34. All contracts provided that "any property held by Parsons outside Alaska for which it holds title shall vest in ARCO upon cancellation and termination of this Agreement without further consideration by ARCO therefore, and Parsons agrees to execute such instruments as are necessary to give effect to."

35. As a practical matter, ARCO could compel Parsons to transfer any of the procured materials at any location to any other location, even another state.

36. Under Contracts 4834, Article XI, 4, 5600 and 6000, Article XXII, p. 4, ARCO is required to insure all "materials, modules, equipment and property acquired or manufactured or constructed." Under the contracts ARCO "assumes (and hereby indemnifies and holds harmless Parsons) and its contractors and subcontractors against all risk of loss of such property at any time, any place, on land, air, or sea or while stationed there or in transit."

37. All three contracts required that Parsons negotiate the best available guarantees and warranties for the benefit of ARCO directly from the subcontractors or manufactures thereof, and it was Parsons' responsibility to assist ARCO in enforcing these guarantees and warranties so obtained. The contracts specifically contemplated and recognized that the warranties for the materials were for ARCO's benefit

from the moment of acquisition. See Contract 4834, Article XI, Contract 5600, Article XXIV and Contract 6000, Article XXIV.

38. Article XIX, Contracts 5600 and 6000 and Contract 4834 provided that ARCO could "suspend, with or without cause, all services by not giving less that 5 days written notice to contractor."

> Such notice shall specify the portion of the service suspended and the number of the contractor's employees who shall discontinue performance of services at the suspension date. Such suspension may be continued by owner for a period of up to ninety days during which the owner shall, by written notice, require contractor to resume performance or terminate that portion of the services which have been suspended.

39. All three contracts enabled ARCO to terminate the agreement at any time, whether or not the contractor was in default, by giving thirty days written notice to the contractor that the agreement is being terminated. In such case, Parsons was obligated to "immediately discontinue services and placing orders for materials, equipment and supplies in connection with the performance of the services, and shall, if requested, make every reasonable effort to procure cancellation of existing orders of subcontracts upon terms satisfactory to ARCO." See e.g. Contract 6000, XX.3.

40. All three contracts were governed by the laws of California.

41. At the outset of each of the contracts, ARCO and Parsons promulgated detailed execution plans for Jobs 4834, 5600 ("Job Instructions") and 6000 ("Procedures Manual"). These execution plans provided complete and detailed guidelines for implementation of the contracts as

agreed by the parties for the duration of the contracts. Critical provisions of the Job Instructions and Procedures Manual are summarized as follows, Copies of which are attached as Exhibits 3 and 4.

a. Section 8.0 provides the procedure for procurement of all materials procured by Parsons on behalf of ARCO. Under 8.1 all Parsons' buyers receive orientation to buying procedures from the Client Procurement Manager (an ARCO employee). The Client Procurement Manager instructs Parsons' buyers on the approved project vendor lists and the execution and procedures manual. At the Parsons' buyers' orientation, each buyer is instructed as to the approval and control requirements of ARCO. ARCO controls the procedures, methods and acceptable vendors for Parsons' procurement personnel.

b. Section 7.0 provides that materials may be procured only from those vendors on the Project Approved Vendor List. Only those vendors approved by the Client Design Support Supervisor, Client Procurement Coordinator and Client Engineering Managers (ARCO employees) are permitted to be on the Project Approved Vendor List. See Section 7.0. ARCO determines and has final approval on the vendors from whom Parsons procures.

c. Section 8.2 (E) provides that ARCO's Client Procurement Group and ARCO's Client Engineering Group must approve in writing all vendors for sole source procurement.

d. All preliminary information concerning the vendors proposed for the Project Approved Vendor List is forwarded to ARCO's Client Procurement Coordinator and ARCO's Client Design Support Supervisor as vendors are obtained.

e. Any vendor removed from the Project Approved Vendor List for unsatisfactory performance may schedule a meeting with ARCO's procurement personnel to discuss the unsatisfactory performance.

f. The Project Approved Vendor List must be reviewed on a quarterly basis by the Parsons' Program Manager of Purchasing with ARCO's Client Procurement Group.

g. Any solicitation of bids from the Project Approved Vendor List in excess of $100,000 must be approved by ARCO's procurement coordinator. A solicitation is a mere request that the vendor bid the materials.

h. ARCO's Client Procurement Coordinator must approve any extension of time for solicitation of bids or any other modification of the procedure.

i. When a bid is received from the vendor, the amount is logged into a requisition activity report. A bid summary is prepared for each of the bids. Should the recommended vendor take exception to the terms and conditions of the purchase, ARCO's legal counsel is consulted. ARCO's legal counsel has final legal authority with regard to acceptance or changes to purchase terms and conditions.

j. Once the purchase terms had been agreed by ARCO, the bid analysis had to be reviewed and approved by ARCO for all orders over $5,000.

k. For blanket acquisitions (acquisitions reflecting an ongoing request for stock items) ARCO's Procurement Coordinator and ARCO's Project Engineer had to coordinate action for any delivery that is not acceptable.

l. If the dollar amount of a blanket amount order was exceeded, ARCO's Senior Procurement Coordinator

had to determine whether to extend, negotiate or rebid the blanket order.

m. Once a bid analysis was accepted and a purchase order was issued and the vendor takes exception to the terms of the purchase order, ARCO's Senior Procurement Coordinator resolved disputes.

42. The purchase orders state on the first paragraph of each order that the "Customer" is "ATLANTIC RICHFIELD COMPANY, Prudhoe Facilities Project, Prudhoe Bay, Alaska" or "ARCO".

43. These procedures have been in effect for both jobs since their inception. In practice, procurement tracked the Job Instructions and Procedures Manual from the outset of each job. See Affidavits from A. R. Van Horn, Parsons' Project Business Manager and E. M. Badarocco, Parsons' Project Procurement Manager for the jobs in question attached as Exhibits 5 and 6. Specifically, Parsons' buyers would receive a purchase requisition from the Parsons' engineers. This requisition by the Parsons' engineer is reviewed and approved by ARCO's engineer.

44. The buyers prepare bid lists from the approved vendor list (vendors are selected and approved by ARCO) and a "Request for Quotation". This request is then issued to the vendors. A "Request for Quotation" is a request to the vendor to provide technical data and price quotations for review by Parsons and ARCO.

45. After the buyer receives vendor quotations he reviews the bid for commercial exceptions and/or clarifications and sends copies to the Parsons' and ARCO's discipline engineers for technical review of exceptions and/or clarifications. ARCO's engineers may request clarification or take exception to any vendor quotation or other technical aspects, or may approve acquisition of the subject property.

46. The Parsons' buyer lists the quotations of all suppliers on a bid analysis summary ("BAS"). The Parsons' buyer and engineer make a joint recommendation for award to the technically acceptable low bidder.

47. The bid is then submitted to ARCO for its review and approval prior to commitment. If ARCO approved the BAS, the buyer prepares a purchase order to the vendor.

48. If ARCO disapproves the BAS the buyer takes the necessary steps to resolve and resubmit for approval.

49. In either case ARCO exercises control over the procurement process from the requisition to final approval, including from whom, under what terms, what type, how and where the materials were acquired.

50. When Job 6000 commenced, ARCO instructed Parsons to use specified terms and conditions on all purchase orders submitted to ARCO approved vendors. These terms and conditions were modified slightly throughout the contract in July 1982 but essentially remained the same as the earlier provisions. [See Exhibit 9 for complete set of both terms and conditions and affidavit. Exhibit 9 also contains an example of a modification to the standard terms and conditions (i.e. the General Electric Purchase Order)]. Each vendor was required to provide materials according to the following conditions.

A. The warranty provision in paragraph 4(b) provided "Seller agrees to repair or replace any material which shall have proved defective or which shall fail to meet said guarantees of design or performance within said periods. Obligations and liabilities of Seller hereunder shall extend to the benefit of Buyer and his Customer named on the face hereof. (Emphasis added).

B. 5 - INSPECTIONS: All materials and equipment shall be subject to inspection and test by Buyer and

Customer at manufacturer's plant, as well as at the place of destination.

C. 9 - INDEMNITY: - Seller hereby indemnifies Buyer and his Customer named on the face hereof against, and shall hold each of them harmless from, any and all loss, damage, liability, cost of litigation, counsel fees, and other expenses arising out of any claim or suit for alleged infringement of patients, trademarks or tradenames, or brands relating to any of the material or equipment described herein, or to use of resale thereof; and Seller agrees to assume the defense of any and all suits and to pay any and all costs and expenses incidental thereto and any judgments awarded therein. This paragraph is not applicable when design of equipment is by Buyer.

D. 11 - SELLER'S LIABILITY: - If the use of Seller's employees, subcontractors, or others under Seller's control at the plant where the material or equipment herein described is to be used or installed is involved in this order, Seller agrees . . . (e) Seller hereby accepts full responsibility, for, and indemnifies Buyer and his Customer against, and shall hold each of them harmless from, all acts and omissions of Seller, its agents and employees. Seller hereby agrees to defend and hereby indemnifies Buyer and his Customer against, and shall hold each of them harmless from, all claims of injury or death of any and all persons (including but not limited to employees) and for damages to property arising out of or in connection with the performance of work hereunder.

E. 19 - LAW OF CONTRACT: This contract and the relationship of the parties whereto shall be covered by and interpreted in accordance with the laws of the State of California.

51. During the years in question ARCO maintained between 100 and 200 employees in Parsons' facilities (Pasadena) to deal with, among other things, materials procurement. ARCO exercised control over disbursement of the funds into the ZBA for the materials acquisition.

52. ARCO approved each significant step in procurement of the materials. The purchase orders indicated to the vendors that ARCO was the "customer".

53. Parsons was required to maintain for ARCO a check register of all checks issued against the zero balance account (ZBA) and submit such register and billing/support to ARCO at regular intervals. ARCO closely monitored the disbursement of funds it deposited in the ZBA.

54. Under the contracts Parsons could not make a reimbursable expenditure from the zero balance account for any thing other than costs directly identified to the job(s).

55. Parsons and ARCO knowingly created a relationship where ARCO controlled the procurement process.

56. On many jobs Parsons performs only engineering, architectural, design, construction and procurement services for clients without selling materials.

57. After a purchase order was submitted to and fulfilled by the vendor, it was Parsons' job to prepare a check to the vendor. When the check reached Republic National Bank, ARCO's funds would be transferred into the ZBA and then directly to the vendor. Under the contract, Parsons had no right to use the funds in the ZBA for any purpose other than to satisfy the procurement obligation.

58. ARCO obtained an immediate property interest in the engineering and design work product.

59. If ARCO had elected to end Parsons' participation after design work was completed outside Alaska, Parsons would have completed an income producing activity

without ever having engaged in or performed or delivered services in Alaska.

60. Parsons' profit was not necessarily contingent upon completion of all stages.

61. Each stage of the contracts in question was treated for Alaska tax purposes by Parsons as a separate income producing activity.

The following Findings of Fact are not part of the Stipulation of Facts, but are adopted as findings by this Hearing Officer.

62. Parsons warranted its work under all the contracts. Ex. 15 at 7; Ex. 17 at 7; Ex. 18 at 4.

63. Parsons was required to insure against any damage to property or person due to its laborers' actions. Ex. 15 at 6, 8-9; Ex. 17 at 6-9; Ex. 18 at 13, Schedule G.

64. Parsons was responsible for paying certain types of taxes resulting from assessments on labor and property values. Ex. 15 at Ex. C, pp 1, 3, 6; Ex. 17 at Ex. B, pp. 1, 3, 6; Ex. 18 at 10-11. Parsons was reimbursed for many of these tax assessments. Ex. 15 at Ex. C, pp. 1, 3, 6; Ex. 17 at Ex. B, pp. 1, 3, 6; Ex. 18 at Schedule A, p. 4.

65. Contract 6000 (Ex. 15 at 10) and Contract 5600 (Ex. 17 at 9-10) allow Parsons to terminate the contract only after a suspension period requested by ARCO has expired. Contract 4834 allows Parsons to terminate the contract after the required 30 day notice. Ex. 18 at 17.

66. Contract 6000 (Ex. 15 at Ex. D, p. 3) and Contract 5600 (Ex. 17 at Ex. C, p. 3) provide:

> Neither the funding of said zero balance bank account nor acceptance of subsequent invoices to the account for such funding shall preclude the right of ARCO to thereafter dispute any of the items invoiced and shall

not be construed as acceptance of any part of the services.

Contract 6000 (Ex. 15 at Ex. D at 3) further provides:

> Contractor's invoices may be adjusted by ARCO for any reimbursable item invoiced by Parsons when such item is not adequately supported or for invoice items not reimbursable as set forth in Exhibit C. Such adjustment may be deducted from the amount of the contractor's next advance funds disbursement from the zero balance bank account.

See also Ex. 17 at Ex. C at 2; *See* Tr. 91.

67. Contract 6000 (Ex. 15 at 1) and Contract 5600 (Ex. 17 at 1) provide that Parsons function as an "independent contractor" under the contract. Contract 4834 states not only was Parsons an "independent contractor", but that it was not "an agent or employee" of ARCO. Ex. 18 at 2-3.

68. The Taxpayer filed returns in California and paid taxes to California on its gross receipts from its design activities. Ex. 11 at 7; Tr. 84-86, 100, 102; TPB at 105. These returns were audited by California, and no adjustments were made concerning that payment. Tr. 100-01.

U.S. CONSTITUTIONAL PROVISIONS AND ALASKA STATUTES AND REGULATIONS

The following constitutional provisions and Alaska statutes and regulations are pertinent to the following decision.

U.S. CONSTITUTION.

* * *

Article 1, ¶ 8. POWERS OF CONGRESS. The Congress shall have power . . . [t]o regulate commerce with foreign nations, and among the several states . . . .

* * *

Article XIV, ¶ 1. CITIZENSHIP RIGHTS NOT TO BE ABRIDGED BY STATES. . . . nor shall any state deprive any person of life, liberty, or property, without due process of law . . . .

AS 43.19.010 ARTICLE IV. DIVISION OF INCOME.

1. As used in this Article, unless the context otherwise requires:

> (a)"Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.
>
> * * *
>
> (g)"Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.
>
> * * *

2. Any taxpayer having income from business activity which is taxable both within and outside this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of income from activities subject to this Article, the taxpayer may elect to allocate and apportion the taxpayer's entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another state if (1) in that state the taxpayer is subject to a net income tax, a franchise tax measured by net income, a

franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not.

* * *

9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

* * *

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sales or;

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and

(1) the purchaser is the United States Government or

(2) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state; or

(b)the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b)the exclusion of any or more of the factors;

(c)the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d)the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

* * *

(¶ 1, ch. 124, SLA 1970)

AS 43.20.065. ALLOCATION AND APPORTIONMENT. A taxpayer who has income from business activity which is taxable both inside and outside the state or income from other sources both inside and outside the state shall allocate and apportion net income as provided in Art. IV of the Multistate Tax Compact (AS 43.19.010) and as provided in AS 43.20.071 for water transportation carriers. (¶ 8, ch. 70, SLA 1975; prior to amendment by ¶ 23, ch. 113, SLA 1980)

AS 43.70.110. DEFINITIONS.

* * *

(2)"Gross receipts" means receipts from sources in the state, whether in the form of money, credits, or other valuable consideration received from engaging in or conducting a business without deducting the cost of the property sold, the cost of the materials used, labor or service cost, interest paid, taxes, losses, or any other expense, except that "gross receipts" does not include cash discounts allowed and taken on sales, and sales refunds, either in cash or by credit, uncollectible accounts written off, and payments received in final liquidation of accounts included in the gross receipts of a previous return made by the person. Receipts from sales, wherever made, of goods, wares, and merchandise manufactured or processed or originating in the state are considered a part of gross receipts from sources in the state, and the holder of a state license under this chapter doing business inside and outside the state is liable under this chapter as to that portion of gross receipts attributable to the Alaska operation. "Gross receipts" also includes all amounts paid or assigned to subcontractors. Individuals representing firms taxed under this chapter on volume of business done, working as agents on commission instead of as employees, may compute their gross receipts as equal to their gross commissions.

* * *

(¶ 2, ch. 43, SLA 1949; ¶ 1, ch. 172, SLA 1957)

15 AAC 19.101. TAXABLE IN ANOTHER STATE; IN GENERAL.

(a)A taxpayer is subject to the allocation and apportionment provisions of this chapter if it has income from business activity that is taxable both within and outside of this state. A taxpayer's income from business activity is taxable outside of this state if the taxpayer, by reason of that business activity (i.e., the transactions and activity occurring in the regular course of a particular trade or business), is taxable in another state within the meaning

of AS 43.19.010, Article IV.3. A taxpayer is taxable within another state if it meets either one of two tests

> (1)if by reason of business activity in another state the taxpayer is subject to one of the types of taxes specified, namely; a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or
>
> (2)if by reason of that business activity another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether the state imposes such a tax on the taxpayer.

(b)A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in that other state pertaining to the production of nonbusiness income or business activities relating to a separate trade or business. (Eff. 5/24/78, Reg. 66)

15 AAC 19.111. WHEN A TAXPAYER IS "SUBJECT TO" A TAX.

(a)A taxpayer is "subject to" one of the taxes specified in 15 AAC 19.101(a) if it carries on business activity in that state and that state imposes such a tax on that activity. Any taxpayer which asserts that it is subject to one of the taxes specified in 15 AAC 19.101(a) in another state shall furnish to the commissioner of revenue of this state upon his request evidence to support the assertion. The commissioner of revenue may request that the evidence include proof that the taxpayer has filed the requisite tax return in the other state and has paid any taxes imposed under the law of that other state; the taxpayer's failure to produce that proof may be taken into account in determining whether the taxpayer in fact is subject to one of

the taxes specified in AS 43.19.010, Article IV.3(1) and 15 AAC 19.101(a) in the other state.

(b)If the taxpayer voluntarily files and pays one or more of those taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but (1) does not actually engage in business activity in that state, or (2) does actually engage in some business activity, not sufficient for nexus, and the minimum tax bears no relation to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified in AS 43.19.010, Article IV.3.(1) and 15 AAC 19.101(a). . . .

(c)The concept of taxability in another state is based on the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in AS 43.19.010, Article IV.3.(1) and 15 AAC 19.101(a) which may be considered as basically revenue-raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in AS 43.19.010, Article IV.3.(1) and 15 AAC 19.101(a) in another state. (Eff. 5/24/78, Reg. 66; prior to amendment by Reg. 81, 3/31/82) 15 AAC 19.251. SALES FACTOR IN GENERAL. (a) AS 43.19.010, Article IV.1.(g), defines the term "sales" to mean all gross receipts of the taxpayer not allocated under AS 43.19.010, Article IV.5 to IV.8. Thus, for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of that trade or business. The following are rules for determining "sales" in various situations:

(1)In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of those goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. "Gross receipts," for this purpose, means gross sales, less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to those sales. Federal and state excise taxes (including sales taxes) must be included as part of those receipts if those taxes are passed on to the buyer or included as part of the selling price of the product.

(2)In the case of cost-plus-fixed-fee contracts, such as the operation of a government-owned plant for a fee, "sales" includes the entire reimbursed cost, plus the fee.

(3)In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency, or the performance of equipment service contracts, research and development contracts, "sales" includes the gross receipts from the performance of those services including fees, commissions, and similar items.

* * *

(Eff. 5/24/78, Reg. 66)

15 AAC 19.281. SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE.

(a)Gross receipts from sales of tangible personal property (except sales to the United States government as defined in 15 AAC 19.291) are in this state

(1)if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale; or

(2)if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.

(b)Property is considered to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

Example: The taxpayer, with inventory in State A, sold $100,000 of its products to a purchaser having branch stores in several states including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. $25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the "purchaser within this state" with respect to $25,000 of the taxpayer's sales.

* * *

(d)The term "purchaser within this state" includes the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

Example: A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of this merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is "in this state."

* * *

(Eff. 5/24/78, Reg. 66; prior to amendment by Reg. 81, 3/31/82)

15 AAC 19.301. SALES OTHER THAN SALES OF TANGIBLE PERSONAL PROPERTY IN THIS STATE. (a) In General. AS 43.19.010, Article IV.17, provides for the inclusion in the numerator of the sales factor, gross receipts from transactions other than sales of tangible personal property (including transactions with the United States government); under this section gross receipts are attributed to this state if the income-producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state, if, with respect to a particular item of income, the income-producing activity is performed within and outside of this state but the greater proportion of the income-producing activity is performed in this state, based on costs of performance.

(b) Income-producing Activity Defined. The term "income-producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income-producing activity includes, but is not limited to, the following:

(1) rendering personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service;

* * *

(d) Application.

(1) In General. Receipts (other than from sales of tangible personal property) in respect to a particular income-producing activity are in this state if

(A) the income-producing activity is performed wholly within the state; or

(B) the income-producing activity is performed both within and outside of this state and the proportion of the income-producing activity performed in this state is greater than in any other state, based on costs of performance.

(2) Special Rules. The following are special rules for determining when receipts from the income-producing activities described below are in this state:

* * *

(C) Gross receipts for the performance of personal services are attributable to this state to the extent those services are performed in this state. If services relating to a single item of income are performed partly within and partly outside of this state, the gross receipts for the performance of those services are attributable to this state only if a greater portion of the services was performed in this state, based on costs of performance. Usually, where services are performed partly within and partly outside of this state the services performed in each state will constitute a separate income-producing activity; in such a case, the gross receipts for the performance of services attributable to this state must be measured by the ratio which the time spent in performing those services in this state bears to the total time spent in performing those services everywhere. Time spent in performing services

includes the amount of time expended in the performance of a contract or other obligation which gives rise to those gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example time expended in negotiating the contract, is excluded from the computations.

* * *

Example (2): The taxpayer, a public opinion survey corporation, conducted a poll by its employees in State X and in this state for the sum of $9,000. The project required 600 man hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man hours were expended in this state. The receipts attributable to this state are $3,000.

200 man hours / 600 man hours X $9,000 = $3,000

(Eff. 5/24/78, Reg. 66; prior to amendment by Reg. 81, 3/31/81)

15 AAC 70.060. CONTRACTORS. (a) General contractors are required to include in gross receipts the entire amount specified by their contracts, without deduction for amounts paid for services hired, cost of material, or any other costs or expenses. General contractors are primary contractors who contract with other parties for the construction of complete jobs and who agree to furnish materials and labor therefor.

Contractors performing contracts on a cost plus or percentage basis will also be considered general contractors.

* * *

(c) Building agents. In cases where the owner or first party to the contract buys the material and hires all labor in his own name and pays an agent a fee on a percentage of

the total cost to oversee and direct the performance of the contract, the agent will be liable for the levy only on the gross amount of the fee on percentage received. See last paragraph of 15 AAC 70.060(a), for determining gross receipts for any license year on unfinished contracts.

* * *

(In effect before 7/28/59)

DISCUSSION

The Taxpayer is a multinational corporation which provides planning, design, engineering, procurement and construction services to various industries and governments. Finding of Fact [F.F.] 14; Ex. 12 at 6-7; Tr. 3. It engages in a variety of petroleum and chemical, mining and metallurgical, public and civic works, transportation, environmental and power and nuclear projects throughout the world. F.F. 14. Its Alaska activities during 1977-1981 were based on a number of contracts, including Contracts 4834, 5600, 6000, 6042, 6095, 6147, 6200, 7013. F.F. 15-18, 20-23. These contracts state that the Taxpayer would provide engineering, design, procurement of materials, construction management, and construction services for creation of environmental modules for the Prudhoe Bay area to maintain existing production of crude oil as field conditions change. F.F. 15, 18; Ex. 4 at 14; Ex. 12 at 7, 9, 32; Tr. 3; TPB at 7-8. These modules were designed for ARCO and subsidiaries of Standard Oil of Ohio [collectively referred to as "ARCO"]. F.F. 15, 18; Ex. 4 at 14.

The Taxpayer filed Alaska Corporation Net Income Tax Returns for 1977-1981 based on worldwide combination, using the standard three-factor formula. F.F. 16; Ex. 12 at 7; Tr. 4. For 1977-1979 and 1981, it allocated the gross receipts received from ARCO for procuring materials in its Alaska sales factor numerator. F.F. 16; TPB at 8. It

excluded the gross receipts attributable to personal services performed outside Alaska from the Alaska sales factor numerator. F.F. 16. For 1980, it calculated its sales factor by allocating the gross receipts from procured materials to states based on the cost of performance or labor hours within each state. F.F. 16; Ex. 12 at 7; Tr. 4; TPB at 8.

The Audit Division audited the Taxpayer for 1977-1979 and examined its various contracts relating to Alaska activities. F.F. 17; Ex. 12 at 7; Tr. 4. It divided the contracts into two groups: contracts involving engineering services only; and contracts involving design, engineering, and construction management services. F.F. 17; Ex. 2 at 58; Ex. 4 at 20; Ex. 12 at 7-8; Tr. 4. The engineering service contracts involved projects in Alaska which did not include any construction of facilities in Alaska by the Taxpayer. Ex. 4 at 17. The gross receipts from these contracts were allocated based on the cost of performance within each state. Ex. 12 at 8; Tr. 4. Since the service contracts were performed outside Alaska, the gross receipts from these contracts were eliminated from the Alaska sales factor numerator. F.F. 17-18; Ex. 4 at 19, 21; Ex. 12 at 8. The Audit Division determined that the contracts involving design, engineering and construction management services were contracts for the sale of tangible personal property. F.F. 18; Ex. 12 at 8; Tr. 4. These contracts' gross receipts were found to be includable in the Alaska sales factor numerator because Alaska was the destination state where the ultimate delivery of the tangible personal property occurred. Ex. 2 at 52, 63; Ex. 12 at 8; Tr. 4-5. Assessments for 1977-1979 were issued. F.F. 19.

The Taxpayers appealed the assessment for 1977-1979 regarding the Audit Division's treatment of the gross receipts from the contracts involving design, engineering, and construction management services. Ex. 2 at 250-58;

Tr. 5. A formal hearing decision, Alaska Revenue Decision (Ak. Rev. Dec.) 83-38 was rendered on October 7, 1983. F.F. 1; Ex. 2 at 274, 288. The decision held that the various personal services phases of the contracts were not separate activities but were all aimed at delivery of tangible personal property in Alaska. F.F. 1; Tr. 5. Since all the receipts from these contracts were associated with the destination state, they were includable in the Alaska sales factor. F.F. 1; Tr. 5-6. The assessed taxes were paid under protest and the decision was appealed to the Alaska Superior Court. F.F. 2-3; Tr. 6. On August 8, 1984, based on an agreement between the parties, the Superior Court remanded the case back to the Department of Revenue to consider other issues and to supplement the record. F.F. 4; Ex. 3; Tr. 6. At the time of the remand, an additional assessment had been issued against the Taxpayer for 1980-1981 involving identical issues. F.F. 5-6; Ex. 4. The parties agreed to consolidate all the tax years in the appeal. F.F. 7; Tr. 6. After the issuance of an informal conference decision which upheld all assessments for 1977-1981, the Taxpayer appealed, requesting a formal hearing. F.F. 8-13; Ex. 13.

Based on the remand and the consolidation of the tax years, all parties agreed that the issues should be given *de novo* review. Ex. 3; Tr. 18-19. The issues in this case generally concern the composition of the sales factor of the three-factor apportionment formula, which determines the amount of sales income apportionable to Alaska. Tr. 3. The Taxpayer makes two basic arguments concerning the calculation of the sales factor. First, it argues its materials theory. TPB at 27-86. Based on this theory, the Taxpayer not only protests the additional assessments, but contends it incorrectly included the value of materials procured on behalf of ARCO in the Alaska sales factor. Ex. 2 at 269; Ex. 12 at 5; Tr. 7; TPB at 10. Based on the expressed terms of the contracts, it maintains it only provided

services, including design, engineering, construction management, construction services, and procurement services. TPB at i-ii, 6; TPR at 2. Regarding the materials and equipment which it purchased, it emphasizes that it did not "sell" any materials to ARCO, but only provided procurement services. Tr. 9; TPB at i-ii, 6; TPR at 1-2. The Taxpayer interprets the pertinent sales factor provisions under AS 43.19.010, Art. IV and 15 AAC 19.251 to require that a taxpayer "sell" tangible personal property" before receipts from such sales are includable in the sales factor. TPB at i; TPR at 1-2. The Taxpayer points out that taxing provisions must be strictly construed. TPB at i, 31. It also maintains its interpretation of the Alaska provisions is consistent with the goals of three factor formula apportionment. TPB at i; TPR at 1-2. Therefore, it maintains that gross receipts received from reimbursements, advances or zero balance bank account transfers are not includable in its sales factor because it did not "sell" tangible personal property, it only sold services. TPR at 4. In an alternative argument under its materials theory, it argues that it acted as an agent of ARCO in procuring the materials at issue. TPB at i-ii, 6, 51-86; TPR at 2. As an agent, it maintains it could not have "sold" items procured on behalf of its principal (ARCO) to the principal. TPB at i-ii, 6; TPR at 2. It maintains it received advances or reimbursement for the procurement of materials and equipment on behalf of its principal. It cites 15 AAC 19.251(a)(3) as requiring only receipts received as a "commission" to be included in an agent's sales factor, maintaining its sales factor must be calculated according to the taxing provisions for sale of services, AS 43,19.010, Art. IV, ¶ 17, not sale of tangible personal property, AS 43,19.010, Art. IV, ¶ 16. TPR at 2. Therefore, under either argument, all receipts attributable to materials and equipment acquisitions would be excluded from its sales factor. TPB at 6; TPR at 2.

Second, and in the alternative, it proposes its place of performance theory. TPB at 86-101. It maintains that if it is determined that a sale of property was involved, the design, architectural and engineering home office activities were separate income-producing activities from the procurement, construction management, and construction services. Ex. 12 at 5; TPB at i-ii, 6, 10; Tr. 7. It contends these two types of activities were separately profitable based on the amount of services performed. It argues that the Audit Division should look beyond the language of the contracts to the substance of the transactions and exclude the receipts from the home office services outside Alaska from the numerator of its Alaska sales factor. Ex. 12 at 6; TPB at i-ii; Tr. 9. Only the gross receipts from procurement of materials and equipment and construction activities involving the property should be attributed to Alaska, the destination state. TPB at ii.

The Taxpayer also raises constitutional issues. TPB at 101-05. The Taxpayer contends that the Alaska sales factor computation violates the due process and commerce clauses of the U.S. Constitution because it includes payments for material procured under ARCO control and payments for home office engineering for work outside Alaska. Ex. 12 at 6; TPB at i-ii.

Finally, the Taxpayer petitions that an equitable adjustment should be made to its Alaska sales factor under AS 43.19.010, Art. IV, ¶ 18 because it has also paid corporation income taxes to California based on the inclusion in the California sales factor numerator of the same gross receipts attributable to the home office engineering which were included in the Alaska sales factor numerator. Ex. 12 at 6; TPB at i, 105-06.

The Audit Division contends that the Taxpayer was a construction contractor who provided personal services to produce environmental modules which were sold and

delivered to ARCO in Alaska. Therefore, it maintains that the Taxpayer's gross receipts resulted from the sale of this tangible personal property and must be assigned to the market state where the property was ultimately delivered - Alaska. Ex. 12 at 10; Tr. 7. It claims that the Taxpayer was not functioning as an agent or trustee of ARCO in acquiring the property which the Taxpayer used to produce the modules. Ex. 12 at 23-46. It explains that the Taxpayer's sales factor was properly calculated according to AS 43.19.010, Art. IV, ¶ 16, based on the gross receipts attributable to sales of tangible personal property.

The Audit Division also challenges the Taxpayer's position that the contracts' design, engineering, and architectural activities can be bifurcated from the contracts' procurement and construction activities. Tr. 7. The Audit Division contends that this analysis goes beyond the actual language of the contract. It maintains that this argument is not available to the Taxpayer, who is bound by the terms of its agreements. Tr. 9. Additionally, it contends that even if this argument were available to the Taxpayer, there was substantial evidence that the substance of the transaction was the construction and the sale of tangible personal property. Tr. 9. It maintains that the final product was considered by both ARCO and the Taxpayers to be of great importance. Tr. 9.

The Audit Division also claims that no due process or commerce clause violations occurred, nor is any adjustment to the Taxpayer's Alaska sales factor warranted because the Taxpayer's income was fairly apportioned, and the Taxpayer has failed to prove that California required inclusion of the gross receipts from the home office services in the Taxpayer's California sales factor numerator. ADR at 4-5.

I. Alaska Income Tax Laws Provide That The Taxpayer's Design, Engineering, Architectural, Construction

Management, and Procurement Services Were Performed To Produce A Product To "Sell" And Deliver To Alaska Customers, And Were Not Performed As An Agent Or Trustee Of Arco.

The Taxpayer maintains it erroneously included in its Alaska sales factor numerator and denominator the gross receipts from reimbursements, advances, and zero balance bank account monies used to purchase ARCO's materials and equipment. Tr. 31-32; TPB at 10, 27. It contends that it did not "sell" this property to ARCO, which it maintains is required by Alaska law in order for the value of such property to be included in the sales factor. TPB at 27-28, 34-51; Tr. 31. It characterizes its business activities involving ARCO as rendering services. TPB at 27; Tr. 31-32. It maintains that the only values that should be included in its Alaska sales factor are the gross receipts attributable to the rendering of services -- engineering, architectural and procurement activities. It claims the gross receipts from these activities as a service provider must be allocated in accordance with AS 43.19.010, Art. IV, ¶ 17 and 15 AAC 19.301. TPB at 28. It contends it overpaid its taxes and requests a refund of $774,981 plus interest. Ex. 32.

The Taxpayer alternatively argues that if it is determined that a "sale" of tangible personal property did occur in the present case, Parsons could not be the vendor and ARCO the buyer. Tr. 56. It maintains this relationship did not exist. It characterizes its relationship with ARCO as purchasing agent or trustee and principal or beneficiary. TPB at 34-85. It states that the property belonged to ARCO, and that it only procured it as an agent or trustee of Arco. e/x. 11; TPB at 27; Tr. 31. It explains that transfers by agents to a principal, even when the agent holds title in the property, are not considered sales, maintaining this is a well-established principal of income tax law. It claims that

none of the indicia of ownership exists here, for it was required to adhere to a number of requirements that established its agency or trustee relationship. TPB at 28; Tr. 31. It characterizes any sale that occurred as between the vendors and ARCO. Tr. 70; TPB at 35. It points out that the vendors knew that they were delivering property to ARCO because its name was listed as "customer" on the purchase orders. Tr. 70. Therefore, only the vendors' sales factor would be affected, and not the Taxpayer's. TPB at 34, 76. It maintains that the applicable Alaska provisions regarding what values are includable in its sales factors are AS 43.19.010, Art. IV, ¶ 17, 15 AAC 19.251(a)(3) and 15 AAC 19.301, including only its commissions from ARCO. TPB at 75.

The Audit Division stands by the finding in Ak. Rev. Dec. 83-38 at 9-11, that the Taxpayer was a construction contractor whose contracts involved personal services provided in connection with the sale and delivery of tangible personal property. Ex. 12 at 10. The Audit Division also contends that the facts in the present case and in *Green Construction Co. v. State of Alaska, Dep't of Revenue*, 674 P.2d 260 (1983) are similar, and therefore it is clear that the Taxpayer was not an agent as determined by the Alaska Supreme Court. Ex. 12 at 34, 40. The Audit Division also maintains that the resulting trust theory proposed by the Taxpayer is an argument available to ARCO only, not the Taxpayer. Tr. 8-9.

To address the Taxpayer's arguments, the contract provisions must be carefully reviewed in light of Alaska law. In analyzing the issues, the focus will be on three contracts, Contracts 4834, 5600, and 6000, which both parties agree are generally representative of all the contracts at issue and were in effect during most of the tax years at issue. F.F. 15-23; Ex. 12 at 9-10; Ex. 15; Ex. 17; Ex. 18; Tr. 5. The contracts involve the same parties and similar

activities. Ex. 15; Ex. 17; Ex. 18; TPB at 10. Parts of the contracts were performed in different states outside Alaska. FF. 16, 18; Ex. 2 at 55, 291; Ex. 4 at 15. For example, the feasibility studies were performed primarily in California. Assemblage and barge preparation occurred in Texas and Washington. Final installation and inspection occurred in Alaska. Ex. 4 at 15.

There are some differences in the contracts. Contract 4834 was executed earlier than the other two contracts, in 1971, and expired in 1979. F.F. 20-23; Ex. 18; Ex. 19; TPB at 10. It was divided into two phases, the design and engineering phase, and the construction management and installation phase. F.F. 28; Ex. 4 at 15; Ex. 12 at 9; Tr. 5. Contract 5600 is an extension of Contract 4834. Ex. 2 at 149; Ex. 17; Ex. 19. Contracts 5600 and 6000 are similar in format. F.F. 22. By 1980, Contract 6000 was the controlling contract. F.F. 23. Contracts 5600 and 6000 were not divided into phases, but integrate the various services which the Taxpayer will provide from the inception of the contract to its completion. Ex. 12 at 7-9; Ex. 15; Ex. 16; Tr. 5. Contracts 5600 and 6000 differ from Contract 4834 in that they only provide for design, engineering, procurement and construction support services. F.F. 22, 26; Ex. 4 at 15-16; Ex. 17 at Ex. A; Ex. 15 at Ex. A. They do not specifically contain a sales phase. However, all the contracts require the Taxpayer to procure materials and equipment necessary to design and construct the modules. Ex. 12 at 10; Ex. 15 at Ex. A, p. 1; Ex. 17 at Ex. A, p. 1; Ex. 18 at 1-2. ARCO exercised control over the procurement process from requisition to final approval, including from whom, under what terms, what type, and how and where the materials and equipment were acquired. F.F. 41-55.

Compensation to the Taxpayer was similarly described in each contract as: reimbursement for direct costs of

materials, equipment, supplies and subcontract labor and other direct costs paid through a zero balance bank account; direct cost of wages plus a payroll burden, paid as a percentage of payroll; overhead reimbursement, paid as a percentage of payroll; and profit, paid as a percentage of payroll. F.F. 29; Ex. 2 at 254-55. There was no markup or profit calculated based on the value of the materials. F.F. 30. As of 1976, payment for materials and equipment was made through the zero balance bank account. F.F. 31.

Other features of the contracts included termination or suspension of the contracts by ARCO. F.F. 38-39. The Taxpayer retained title to the materials and equipment used in the construction of the modules until the modules were delivered to Prudhoe Bay or upon termination of the contract by ARCO. F.F. 33-34; Ex. 2 at 63, 165, 291; Ex. 12 at 9. ARCO insured all "materials, modules, equipment and property acquired or manufactured or constructed" and assumed all risk of loss. F.F. 36. The Taxpayer was responsible for insuring against injuries or damages by its laborers. F.F. 63. The Taxpayer warranted its work. F.F. 62. The Taxpayer also paid for taxes assessed based on property and labor, although it appears ARCO reimbursed the Taxpayer for much of this expense. F.F. 65. The Taxpayer was listed as an independent contractor in all three contracts, while Contract 4834 additionally states that the Taxpayer was not an agent or employee of ARCO. F.F. 67.

A. The Taxpayer's Engineering, Construction Management, And Procurement Services Were Performed In Order To Sell Tangible Personal Property To A Customer In Alaska.

The Taxpayer asserts that the applicable Alaska law regarding inclusion of a contract's gross receipts in the sales factor requires that a "sale" of personal property occur, citing AS 43.19.010, Art. IV, ¶¶ 1(g), 15-16, 15

AAC 19.251(a) and 15 AAC 19.281(a). TPB at 28-32, 35; Tr. 54, 74. It relies on *Black's Law Dictionary*, 5th Ed. at 1200, definition of "sale": a contract whereby property is transferred from one person to another for a consideration of value, implies the passing of title, as distinguishable from a special interest short of complete ownership." TPB at 35. It further contends that requiring a "sale" is consistent with the goals of three factor formula apportionment. It explains that allocating the gross receipts of a sale to the destination state attributes the *gain* from the sale to the state. TPB at 33-34. It contends that the applicable Alaska law regarding what values should be included in its sales factor are AS 43.19.010, Art. IV, ¶ 17 and 15 AAC 19.301. TPB at 31. These provisions concern sales of other than sales of tangible personal property. This would include rendition of personal services. It argues that tax laws must be strictly construed against the state and in favor of the taxpayer, citing *Union Oil Co. v. State of Alaska, Dep't of Revenue*, 560 P.2d 21, 24 (Alaska 1977) and other legal authorities. TPB at 31-33.

The Taxpayer claims that the Audit Division has transformed service contracts into sales contracts. TPB at 1. It acknowledges that the Audit Division did correctly identify certain general service contracts as sales of other than tangible personal property, and has correctly allocated the sales gross receipts to the states where the services were performed, outside Alaska. TPB at 11. It maintains, though, that the remaining contracts provide for the sale of services - engineering, procurement, construction management and construction services - as expressly provided by the terms of the contracts. The Taxpayer cites the prefatory language in Contracts 5600 and 6000 to support its position that the Taxpayer's business is performing professional services, and not selling materials. Ex. 15 at 1; Ex. 17 at 1; Tr. 38, 65. These provisions state that the Taxpayer is to provide professional services.

Additionally, it emphasizes that the compensation sections of the contracts provide that profit be based exclusively on services. Tr. 38. The contracts state that the Taxpayer is to be reimbursed for only the direct cost of wages and materials and equipment. The compensation for the payroll burden and an overhead reimbursement were based on a percentage of the hours worked. Profit was based on a percentage of payroll. F.F. 29; Tr. 38. There was no markup for materials. F.F. 30; Tr. 38. As the Taxpayer explains, "Parsons was not permitted to make a dime on the sale of the tangible personal property or the transfer from the vendor to ARCO." Tr. 38. Other factors listed by the Taxpayer as indicating that it was in the business of providing services and not selling property were: it did not employ assembly labor; did not maintain inventories; was liable for engineering and design deficiencies as opposed to materials deficiencies; was required to transfer materials when requested by ARCO; and, ARCO bore all risks of loss. Ex. 11 at 3.

The Taxpayer cites several decisions that hold that a general contractor responsible for engineering and construction does not "sell" materials procured on the owner's behalf under the UCC and Arizona transaction business tax decisions. TPB at 41-49; TPR at 2, 4. The Taxpayer maintains these decisions support its position that construction companies sell services and not goods or tangible personal property.

The Audit Division contends Ak. Rev. Dec. 83-38 at 9-11 sufficiently resolves this issue in its finding that the Taxpayer's contracts involved personal services provided in connection with the sale and delivery of tangible personal property. Ex. 12 at 10, 12. The Audit Division characterizes the Taxpayer as a construction contractor that renders a skill with the objective of construction and delivering tangible personal property. It contends the

Alaska contracts at issue are normal construction contracts for the industry, citing the Taxpayer's annual reports and SEC filings to support its position. Ex. 12 at 31-32. It contends that as a matter of law, the gross receipts from contracts involving this type of activity must be assigned to the state where the ultimate delivery of the property occurs, citing AS 43.19.010, Art. IV, ¶ 16. Ex. 12 at 10, 13.

The Audit Division maintains this characterization of the Taxpayer's activities is consistent with the controlling law regarding what constitutes a "sale" for Alaska income tax purposes, as found in 15 AAC 19.251(a). ADR at 2. 15 AAC 19.251(a) provides that "sales" include "all gross receipts derived by the taxpayer from transactions and activity in the regular course of that trade or business". It points out that 15 AAC 19.251(a)(2) provides that "in the case of cost-plus-fixed-fee contracts, such as the operation of a government owned plant for a fee, sales includes the entire reimbursed cost, plus the fee". It additionally refers to the Alaska Business License Act [ABLA] provision, 15 AAC 70.060(a), which holds that "general contractors are required to include in gross receipts the entire amount specified by their contracts". It maintains that these provisions make it clear that the object is to assign the sales value of a contractor's contract to the market destination state to account for the economic environment in which income is realized. ADR at 2.

The Audit Division distinguishes the decisions cited by the Taxpayer. It claims the decisions relying on UCC definitions are irrelevant in determining whether the Taxpayer is subject to Alaska income tax, citing *Dep't of Revenue v. Debenham Electric Supply Co.*, 612 P.2d 101 (Alaska 1980). ADR at 2. It also contends the Arizona transaction business tax decisions are irrelevant because they involve agency, which does not exist here. ADR at 2. It maintains the Alaska Supreme Court tax decision of

Green controls regarding whether agency exists. Ex. 12 at 34, 40.

The Taxpayer responds by attacking the Audit Division's reliance on ABLA provisions and decisions involving the ABLA. TPB at 80. The Taxpayer claims any analogy to the ABLA provisions and decisions, such as *Green*, is inapplicable because the ABLA definition of taxable "gross receipts" is broader than under the Alaska income tax provisions. Tr. 67; TPB at 33, 49-50, 77. It points out that there is no requirement of a "sale" under the ABLA. The Taxpayer agrees that under the ABLA, its gross receipts are includable in the tax base. Tr. 67. However, it maintains to employ the same definition here is contrary to the income tax provisions. It stresses that the Alaska income tax provisions distinguish between different types of activities, such as sales of tangible personal property and sales of personal services. Tr. 68; TPR at 2-5. It also contends that 15 AAC 70.060 is irrelevant because it is a business license tax provision with a different focus than the income tax provisions. TPR at 4. It maintains that this provision does not distinguish between sales of tangible personal property and sales of other than tangible personal property, as provided under the income tax sales factor provisions. Additionally, it distinguishes the ABLA provisions and decisions by claiming that even an agency relationship would not exempt the agent from taxation under the ABLA unless certain other criteria were met, such as (1) principal for whom the agent acted was taxable under the ABLA; and (2) agent was paid commissions. TPB at 49-50. Therefore, it maintains the ABLA provisions and decisions are inapplicable in determining whether an agency relationship exists for purposes of Alaska income tax imposition.

The Taxpayer additionally challenges the Audit Division's interpretation and application of 15 AAC

19.251(1)-(2). Tr. 68-69. In that regulation, cost-plus-fixed-fee contracts are discussed. The Taxpayer points out that here reimbursement rather than a fixed fee arrangement was involved. The Taxpayer also contends the Audit Division's interpretation of 15 AAC 19.251 as consistent with 15 AAC 70.060(a) would include all gross receipts from construction contracts in the sales factor when the contract requires construction and delivery of a project, even if the taxpayer is a commercial carrier or a company which physically modifies the property. TPR at 2-6. It maintains that this interpretation is inconsistent with AS 43.19.010, Art. IV, ¶¶ 16-17 and case law, citing *Debenham*. It explains that AS 43.19.010, Art. IV, ¶¶ 16-17 distinguishes between: (1) gross receipts from sales of personal property, subject to allocation under 15 AAC 19.281; and gross receipts from sales of other than tangible personal property, subject to allocation under 15 AAC 19.301. It interprets the references in 15 AAC 19.251 to "gross receipts" and "transactions and activity in the regular course of that trade or business", refers to the type of business in which the taxpayer is engaged which generates gross receipts: (1) sales of tangible personal property; or (2) sales of other than tangible personal property. It also contends that the Audit Division's interpretation fails to give any weight to the form and specific terms of the contract which the Taxpayer claims is critical, citing *Nitrin, Inc. v. Bethlehem Steel Corp.*, 342 N.E.2d 65 (Ill. 1976) and Green. If the contract calls for sales of services, it argues that the services should be allocated based on AS 43.19.010, Art. IV, ¶ 17, even where the services involve agency procurement.

The Taxpayer also defends its reference to the UCC term "goods" as analogous to tangible personal property found in the income tax provisions and the cases involving the UCC, claiming that the Alaska Supreme Court in *Debenham* did not rule that the UCC is irrelevant in income

tax cases. TPR at 2. It claims it just distinguished the term "merchant" under the UCC from "dealer" under the ABLA. It maintains that the Court did use a UCC definition and a decision involving the UCC in defining terms, and therefore the UCC is relevant to determine whether the Taxpayer as a contractor sold tangible personal property. The Taxpayer agrees that Nitrin held that the UCC was inapplicable, but maintains this holding supports its position. TPR at 2-3. It maintains the court found that a contractor does not sell "goods", which the Taxpayer claims is an identical concept to a contractor not selling "tangible personal property" under AS 43.19.010, Art. IV, ¶ 16, but rather sells "services". The Taxpayer also claims that *Debenham*, 612 P.2d at 1002, held that construction companies sell services and not "materials" for purposes of the ABLA, for "[t]he occupation of a contractor essentially involves the rendering of a skill and the materials that pass are incidental." TPR at 2-3. It therefore claims that the Audit Division cannot maintain that a contractor is a service provider under the ABLA but a seller of tangible personal property for income tax purposes.

The Alaska income tax provisions incorporate the Multistate Tax Compact, AS 43.19 *et. seq.* The Multistate Tax Compact prescribes a three factor formula to apportion or allocate all business income of multistate taxpayers, which includes property, payroll and sales factors. AS 43.19.010, Art. IV, ¶ 9. The sales factor is defined in AS 43.19.010, Art. IV, ¶¶ 15-17, requiring inclusion of gross receipts from "sales" of tangible personal property and "sales" of other than tangible personal property. See also 15 AAC 19.281; 15 AAC 19.301.

While the Taxpayer does not contest that a "sale" of its services occurred under the Multistate Tax Compact, it does not concede that a "sale" of tangible personal property occurred. Therefore, it appears that the objections raised

by the Taxpayer are based on how its activities are characterized, rather than if a "sale" occurred. However, regardless of the distinction made by the taxpayer concerning its activities, it is clear that the definition of "sales" as used in the Multistate Tax Compact to describe the gross receipts attributable to the sales factor is broad. The meaning of the term is not as restrictive as the Taxpayer advocates. "Sales" is defined in AS 43.19.010, Art. IV, ¶ 1(g) as "all gross receipts of the taxpayer not allocated under paragraphs of this Article". Therefore, it is an all inclusive term covering all income not specifically dealt with in other paragraphs 5-8 of the article. In *Coulter Electronics, Inc. v. Florida Dep't of Revenue*, 365 So. 2d 806, 808 (Fl. 1978) (emphasis in original), the court explained that the term "sales" used in the Multistate Tax Compact to define what type of gross receipts are includable in the sales factor includes "gross receipts derived from services or other sources *not traditionally viewed as sales*". All that was required for a "sale" under the income tax provision was a transfer or exchange of goods or services. In Ak. Rev. Dec. 87-20 (June 9, 1987) at 49-50, involving an Alaska corporate income tax assessment, it was held that a "sale" occurred between the Taxpayer and the federal government, and that the entire reimbursable payments from overhead fee, subcontractor costs, and materials and equipment purchases based on a cost-plus-fixed-fee contract between the taxpayer and the federal government were subject to inclusion in the Alaska sales factor numerator, citing 15 AAC 19.251(a)(2) and the Alaska Supreme Court's holdings in Green and *Alyeska Pipeline Service Co. v. Williams, 687 P.2d 323 (Alaska 1984). See also United States v. New Mexico, 455 U.S. 720 (1982), cited in Green Construction Co. v. State of Alaska, Dep't of Revenue*, 674 P.2d at 264.

These Alaska Supreme Court tax decisions are more informative as to the meaning of "sale" and taxable gross

receipts under income tax provisions than are the Taxpayer's UCC and non-Alaska decisions. Green and Alyeska involve ABLA assessments. The definition of taxable "gross receipts" may be broadly defined in the ABLA. However, in light of the fact that the imposition of a gross receipts tax is based on the full amount of the contract price, the inclusion of a contract's gross receipts in just the sales factor numerator of a three factor numerator of a three factor apportionment formula for income tax purposes is less onerous. In *Green* and *Alyeska*, the entire amount of the taxpayer's contract gross receipts were subject to Alaska taxation, including reimbursements to the taxpayers from zero balance bank accounts for materials and payments to contractors to construct the trans-Alaska pipeline system.

These Alaska Supreme Court gross receipts decisions are also relevant in determining the type of business the Taxpayer in the present case was involved in because similar factual situations exist. Like the taxpayers in *Green* and *Alyeska*, the Taxpayer was involved in providing services to produce a finished product. Their contract gross receipts were viewed as payment for both services and a tangible product. It is clear that the Taxpayer's contracts here required the Taxpayer to perform services and procure the materials and equipment necessary to produce the modules. In fact, in the later contracts, the procurement of materials and equipment for ARCO was so integrated into the contracts that no separate phase of the contract exists outlining the sale and transfer of the property. The modules that incorporated the procured property were more than just "incidental" to the services rendered. It is clear that the contracts required more than just rendering service.

The contracts at issue here differ from the other type of Alaska contracts which were not included by the Audit Division in the Taxpayer's sales factor numerator: the

contracts only requiring services - design, engineering, and architectural services. No finished products destined for Alaska were produced by the Taxpayer under these other types of contracts. The contracts at issue here are distinguishable and involve sales of tangible personal property, subject to 15 AAC 19.251(a)(2) and 15 AAC 19.281 in determining how the gross receipts from such sales are to be apportioned. This determination is consistent with the goals of three factor formula apportionment, that the gross receipts from sales of a product should be attributed to the destination state. See TPB at 34, 76.

It is also clear from the ABLA tax decisions and 15 AAC 19.251(a)(2) and 15 AAC 19.281 that the form of payment is irrelevant as to whether the gross receipts are taxable. These decisions and provisions hold that reimbursements, advances and transfers from zero balance bank accounts were taxable gross receipts. Additionally, in *United States v. New Mexico*, *supra*, advances through a zero balance bank account to pay for property procured by the taxpayer and its labor costs constituted taxable gross receipts. Also, 15 AAC 19.251(a)(2) clearly states that the gross receipts from a cost-plus-fixed-fee contract are includable in the sales factor numerator. This would include the reimbursed costs, even if no markup or profit was directly calculated based on the cost of the procured materials and equipment.

B. The Taxpayer Has Not Demonstrated That It Was ARCO's Agent Or Trustee.

The Taxpayer claims it was ARCO's purchasing agent or trustee of the materials acquired. Ex. 11 at 2-3; Tr. 86; TPB at 28, 35-36. Based on legal tenets regarding agency, it explains that it could not "sell" materials it acquired on behalf of its principal to its principal, or as a trustee it could not "sell" materials belonging to the beneficiary to

the beneficiary which held "equitable title". It contends it acted as a conduit in acquiring all the property for ARCO, using ARCO's funds principally from a zero balance bank account rather than its own. Ex. 11; Ex. 12 at 5, 25; Tr. 8; TPB at 34-35.

The Taxpayer maintains that to require it to include the gross receipts from the advances, reimbursements or zero balance bank account transfers regarding the property acquired for ARCO in its sales factor would grossly distort its apportioned income to the destination state, Alaska. TPB at 28, 34-35. It maintains that distortion would occur because both the vendor and the procurement agent would allocate sales for the same property, inflating the sales ratio of the destination state. It maintains that as an agent, its sales factor should include only the gross receipts attributable to its rendition of services in accordance with the rules governing allocation of receipts from sales of services.

The Taxpayer's agency and resulting trust theory can be summarized as based on the following factors: the extensive control exercised by ARCO over procurement; the Taxpayer's submission to ARCO's control; the extension of purchasing protections to ARCO; non-existence of profit; and the disclosure of ARCO as the customer to the vendor. Tr. 72-73, 64; TPR at 7.

The Taxpayer contends that ARCO controlled the procurement process, including: selection of the contract terms regarding procurement of the materials and equipment; detailed procedure manuals to be followed by the Taxpayer's and vendors' personnel; approval of vendors; solicitation of bids; approval of procurements over $10,000 as well as blanket requisitions; and approval of significant steps in the procurement process. F.F. 41-55; Ex. D; Ex. E; Tr. 41, 45-53, 58, 63-64, 72-73; TPB at 61, 63-65, 85. The Taxpayer contends based on these factors

as summarized in F.F. 49, the Taxpayer must be recognized as acting as ARCO's agent as a matter of law. Tr. 39; TPR at 1. F.F. 49 provides that:

> In either case ARCO exercises control over the procurement process from requisition to final approval, including from whom, under what terms, what type, how and where the materials were acquired.

The Taxpayer also claims the zero balance bank account established ARCO's control over material acquisition. Tr. 38-39, 49-53; TPB at 63, 65. The Taxpayer explains that ARCO's money was used to purchase the materials, and that ARCO controlled this money. The Taxpayer disagrees with the Audit Division's characterization of the management of the zero balance bank account as the Taxpayer's responsibility. Tr. 64. It maintains ARCO was knowledgeable as to the amount of money transferred into the zero balance bank account. The Taxpayer also attacks the Audit Division's position that the Taxpayer could have used the money for any purpose, claiming such a position is analogous to an employee helping himself or herself to the company till. TPR at 6. The Taxpayer contends the purpose of the zero balance bank account was "to maximize the efficient use of and visibility of ARCO provided funds," more than just an efficient financing technique, as characterized by the Audit Division. Tr. 39, 49-53, 72-73.

The Taxpayer claims that certain purchasing protections exemplify its agency relationship with ARCO. It emphasizes that the critical elements of ownership revolve around who bears the loss, who makes the profit, who would benefit upon delivery of the property, and who directed and controlled the other's activities. Tr. 65. The Taxpayer points out that ARCO insured and bore the risk of loss on all materials procured by the Taxpayer. TPB at 63, 67, 85; F.F. 36. All warranties were procured on behalf of

ARCO. Tr. 43-44; TPB at 67; F.F. 50. Additionally, ARCO conducted in-depth audits of the Taxpayer's disbursements, was entitled to access the Taxpayer's books and records and its facilities concerning the contract jobs, and monitoring its activities. Tr. 44-45; TPB at 67. It cites the suspension and termination provisions of the contracts as supportive of ARCO's authority over the property which required transfer of the property and title held by the Taxpayer to ARCO. Tr. 64-65; TPB at 61. The Taxpayer tries to downplay the emphasis placed by the Audit Division on the Taxpayer's retention of title to the property. TPB. 61. It stresses that it only held title for a limited period, and therefore claims this factor is irrelevant. It maintains it was always clear that the property belonged to ARCO, but was procured by the Taxpayer on ARCO's behalf as authorized by ARCO with ARCO's money. It also explains that purchasing agents like itself do not maintain inventories, recognize any appreciation in the value of acquired property, do not have a tax basis in the property, and do not recognize any loss. Tr. 56-57. The Taxpayer concludes that this level of control by ARCO over the property at issue exemplified through the above listed factors was greater than the control exercised in many of the decisions recognizing agency. TPB at 61.

The Taxpayer also contends it did not profit from any of the property transfers, indicating agency. F.F. 29; Ex. 2 at 254-55; Tr. 73; TPB at 62, 82. The Taxpayer repudiates the Audit Division's implication that the Taxpayer's fee was based on something other than services. The Taxpayer points out that there was no markup on the property, no profit or fee measured by the value of the materials. The Taxpayer maintains the only gross receipts it received concerning the property simply covered the cost of the property. It maintains that the only profit it received was based solely on the actual services rendered. It maintains

this type of compensation resembles a commission arrangement paid to a purchasing agent.

The Taxpayer further maintains that industry perception and recognition of an agency role is a factor in demonstrating agency. TPB at 68-69. The Taxpayer states that by indicating to the vendors on the purchase order forms that ARCO was the "customer" advertised to all that ARCO was the true buyer. Ex. C; Tr. 39-40, 64; TPB at 64-65.

The Taxpayer contends that California law governs whether agency exists. TPB at 51; TPR at 7. It relies upon Cal. Civ. Code ¶ 2295 for the definition of agent - "an agent is one who represents another, called the principal, in dealings with third persons. . . ." TPB at 51. It further argues that an agency relationship may be created by written instrument, orally, or implied by the conduct of the parties, citing California decisions. TPB at 51. It therefore contends that although the contracts at issue state that the Taxpayer is an independent contractor, this fact is not controlling as to whether an agency relationship exists. TPB at 52-53. Therefore, it distinguishes the agency decisions cited by the Audit Division as not based on California agency law, or irrelevant because based on gross receipts tax decisions. Ex. 11 at 2; Tr. 56. The Taxpayer does, though, cite non-California decisions to support its position on agency, many of them non-tax decisions. TPB at 52-58, 62-69; TPR at 5. The Taxpayer also attempts to distinguish the non-existence of an agency relationship in *Green* from the present case. TPB at 85; TPR at 5, 7. It explains that the Court in *Green* found that the contract "expressly" precluded Green from acting as an agent. *See, Green Construction Co. v. State of Alaska, Dept. of Revenue*, 674 P.2d at 263. It claims in the present case that the substance of the Taxpayer's contracts with ARCO created an agency relationship. It explains that an agent-

principal relationship can exist with or without any expressed contractual provision. It maintains that this is the key difference.

The Audit Division claims that the Taxpayer was not ARCO's agent. ADR at 2; Tr. 93. It admits that the Taxpayer has demonstrated that some control existed, exercised by ARCO over the Taxpayer through the procurement process. Tr. 89-90, 93. It characterizes this type of control, though, as ARCO's desire to control its costs in the most efficient manner, considering the magnitude of the project. The Audit Division points out that ARCO's control over the procurement process was limited in certain respects. F.F. 32, 62-65; Ex. 12 at 42-43; Tr. 42-43, 73; TPB at 66. The Taxpayer retaining legal title to the procured materials and equipment until it was delivered to Prudhoe Bay. It was responsible for insuring its own employees and certain other items, and was liable for any personal injury, death or damage to property arising out of the Taxpayer's work. The Taxpayer warranted its work. It was responsible for hiring employees and making payments for purchases. It obtained worker's compensation insurance, employers liability insurance, comprehensive bodily injury, personal injury and property damage liability insurance, and was obligated to require its subcontractors to carry these same type of insurance coverages. It also was also responsible for all taxes.

The Audit Division also maintains that the zero balance bank account methodology exemplifies the type of non-agency relationship which existed between the parties. Ex. 12 at 39; Tr. 90-92; ADR at 3. It contends that the Taxpayer had control over the money. The account was in the Taxpayer's name, and only the Taxpayer was authorized to write checks on the account. It maintains that ARCO simply pre-approved the purchases but did not

actually make the purchases. It further contends it was not absolutely necessary for the Taxpayer to get pre-approval. It claims that while "under the contracts" the Taxpayer could not use the zero balance bank account funds for any other purpose than for authorized procurement, it does not mean that the Taxpayer could not simply use the money for other purposes. Only after ARCO reviewed the invoices could the purchases be challenged. The Audit Division contends the zero balance bank account is no different than any other reimbursable method of payment, more efficient for contractors by avoiding delays awaiting money transfers and additional interest. It characterizes the ABA as simply an efficient financing technique. Ex. 12 at 40; Tr. 92.

The Audit Division emphasizes that not only does agency demand that the principal have control over the agent, but that the agent has certain controls over the principal, such as the right to establish legal obligations on behalf the principal. Tr. 89; *See Green Construction Co. v. State of Alaska, Dep't of Revenue*, 674 P.2d at 265-66. It maintains that this has not been demonstrated here. The Audit Division cites references in the Taxpayer's contract regarding ARCO's authority to reject purchases made by the Taxpayer's use of the zero balance bank account monies and to withdraw compensation. F.F. 66; Tr. 91.

The Audit Division also refutes the Taxpayer's claim that it acted as trustee of ARCO's property under the resulting trust doctrine. Ex. 12 at 5, 44-45; Tr. 8. The Audit Division points out that it was the Taxpayer who wrote the checks from the zero balance bank account in its name to the sellers of the property. ARCO did not pay for the property directly as required to create a resulting trust. Transfer of title could be due to a breach of contract, which is not the basis for transferring property in a resulting trust situation. The Audit Division also maintains that the

resulting trust theory may be available to ARCO but not to the Taxpayer, and therefore is not applicable. Tr. 8-9.

The Audit Division additionally contends that the Taxpayer did receive a fee for its services and procurement of materials, regardless if it were fixed or a percentage. Thus, it contends the Taxpayer's distinction that it received a commission because the fee was based on a percentage is illusory because all that is required is that the sales factor include "the entire reimbursed cost, plus the *fee*" under 15 AAC 19.251(a)(2). ADR at 3.

The Audit Division further maintains the designation of ARCO as "customer" is simply an accounting device, allowing early correlation of invoices with jobs to eliminate confusion. ADR at 4. It explains that this type of labeling is standard in the business community. The Audit Division further points out that ARCO is designated as "customer", not "principal". ADR at 4. It additionally points out that there is nothing on the form nor the contracts, drafted by *both* the Taxpayer and ARCO, to indicate that the Taxpayer is ARCO's agent. It also points out the absence of evidence from ARCO indicating that the Taxpayer was its agent. ADR at 4.

The Audit Division distinguishes the decisions cited by the Taxpayer by claiming that they do not represent the facts in the present case. ADR at 2. It maintains that *Green* controls regarding whether an agency or trust relationship existed because the facts are similar. It emphasizes that no agency relationship was found to exist in that decision.

Several of the legal authorities cited by the Taxpayer simply espouse that an agent does not "sell" property to its principal. TPB at 34-40, 46-51. There is no disagreement with this legal premise by the Audit Division. The issue is whether the Taxpayer qualifies as an agent. California law does not dictate whether the Taxpayer's relationship with

ARCO falls within the agency definition found in Alaska tax provisions. There is ample authority provided by Alaska tax decisions to reach this issue. The Alaska Supreme Court cases are more illuminating than the cases cited by the Taxpayer from other jurisdictions involving non-tax cases as to what constitutes agency for tax purposes. Additionally, the facts in the Alaska cases are more similar to the present case than the facts in the cases cited by the Taxpayer.

In *Green*, the Alaska Supreme Court addressed an agency claim based on facts similar to the present case. *See also* Ak. Rev. Dec. 83-15 (May 6, 1983) at 26-27. The Court cited the *Restatement (Second) on Agency*, ¶ 1(1) (1958) to define "agency":

> Agency is the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act."

674 P.2d at 265. An agency relationship requires that an agent will act on behalf of the principal and is subject to the principal's control. The right of control by the principal is paramount. *Restatement (Second) on Agency*, ¶ 14. However, there must also be a manifestation that the agent knows it is acting on behalf of the principal. 674 P.2d at 265. The agent must consent to act on behalf of the principal. *Id.*

It is therefore clear from *Green* that the issue is not what type of control ARCO exercised over the procurement process or zero balance bank account, but what type of control ARCO exercised over the Taxpayer. ARCO's control over the Taxpayer and the Taxpayer's consent to that control is not so evident.

In the present case, there were certain factors that demonstrated ARCO's control over the Taxpayer. ARCO

did receive the list of the Taxpayer's key personnel and was authorized to order replacement of these personnel if it was determined that their services were unsatisfactory. F.F. 25; TPB at 65, 84. The Taxpayer's procurement personnel were instructed in and subject to ARCO's buying standards. F.F. 41; TPB at 85. ARCO also maintained between 100-200 personnel at the Taxpayer's facilities to deal with material procurement. F.F. 51; TPB at 65. It is evident that most of this control by ARCO relates to the procurement process, or is simply a supervisory function evident in non-agency relationships as a means to insure compliance with contract terms. In *Green*, *Alyeska*, and *United States v. New Mexico*, the Courts rejected the taxpayers' claims that an agency relationship existed because of the significant control by another over the acquisition of materials, labor and payment, which is similar to the type of control exercised by ARCO in the present case. The courts explained in *Green*, *Alyeska*, and *United States v. New Mexico*, that limited control is exercised by the reimbursement or advance payment account system. *See also* Ak. Rev. Dec. 83-15 at 29. The requirement of prior or post approval of expenditures is for reimbursement purposes, not an exercise of control over another's right to purchase. The expenditures are not controlled, only the reimbursement of expenditures is controlled. The control of reimbursable costs does not mean the control of another's actions. It was the taxpayers who incurred obligations in the course of their business dealings with another who simply reimbursed them. In *United States v. New Mexico*, the U.S. Supreme Court cited the lower court decision in explained the limited significance of the advanced funding to pay for a contractor's expenditures, citing the language of the lower court:

> Advanced funding, the court declared, "is simply another means of reimbursement devised by

> accountants to eliminate major weaknesses in the government's bookkeeping practices." *Id.*, at 119. In meeting overhead and salaries with Government funds, the contractors were satisfying their own obligations, and they exercised dominion over the funds by issuing drafts to obligees. And insofar as the claims of third-party vendors are concerned, the court found federal "responsibility for properly incurred claims to be inherent in all cost-type contracts," id., at 119, n 9; any number of businesses act under letters of credit from banks and other sureties, and the Federal Government itself finances a variety of organizations-including States and local governments-in such a manner.

The factual situations in some of the above listed cases rejecting agency suggest a stronger case for agency than the present case. In United States v. New Mexico, the contractors placed orders for materials with third-party suppliers in their own name, with payment based on advances from the U.S. Government deposited in what was comparable to a zero balance bank account. Two of the contractors were authorized to "pledge the credit of the United States." 455 U.S. at 726. Annual vouchers of expenditures were submitted to the Government for approval. Two of the three contractors involved were compensated by a cost plus fixed fee, while the third was paid reimbursement costs only and no fee. Title and the risk of loss passed directly from the vendors to the U.S. Government. The Court specifically noted that the Government "maintains control over the contractors' procurement systems, property management and disposal practices, method of payment of operational costs, and other operations under the contract. 455 U.S. at 729.

In another U.S. Supreme Court case involving agency, *Alabama v. King and Boozer*, 314 U.S. 1 (1941), the Court

rejected the contractor's claim that the U.S. Government's control over the contractor's reimbursable purchases constituted an agency relationship. The Court found that the U.S. Government exercised extensive control over the contractor's purchases. Government officers made the decision on whether to buy and what to buy. Purchases of materials of $500 and over had to be approved in advance by the Government's contracting officer. The government reserved the right to approve the price and to furnish the material itself, if it so elected. The Government inspected and approved the purchases (lumber) before shipment. The Government reimbursed all the contractor's expenditures, even taxes.

In *U.S. v. Boyd*, 378 U.S. 39 (1964), involving a use tax, the contractors performed maintenance and construction work at U.S. Government facilities under the direction of the Government. Materials were procured and paid for with Government funds under an advanced funding arrangement. The purchase order forms specifically stated that the purchases were made "for and on behalf of the Government". Title passed directly from the vendor to the U.S. Government. The contractor owned none of the property, receiving a fixed annual fee for its services. The Court held:

> "The vital thing" is that [the contractors are] "using the property in connection with [their] own commercial activities." That the federal property involved was being used for Government's benefit-something that by definition will be true in virtually every management contract-was irrelevant, for the contractors remained distinct entities pursuing "private ends," and their actions remained "commercial activities carried on for profit".

378 U.S. at 44, citations omitted.

In *Green Construction Co. v. State of Alaska, Dep't of Revenue*, 674 P.2d at 265-66, the Alaska Supreme Court also placed great weight in determining whether an agency relationship existed based on the extent of the taxpayer's independent unsupervised activities under the contract. The Court found that the taxpayer furnished services through its own labor, although some work was subcontracted, and procured all the necessary materials and equipment. In the present case, the Taxpayer was also responsible for such activities. The purchase of the equipment and materials was integrated with the Taxpayer's service activities. The Taxpayer was responsible for the overall management of the project. It played an active role in the creation of the modules and was not directly supervised by ARCO.

Additionally, the courts in *Green*, *id.*, and *United States v. New Mexico*, 455 U.S. at 735-77, emphasized that no matter how extensive the restriction of a contractor/taxpayer by the alleged principal, the major focus of the agency issue is whether the contractor/taxpayer was free to obligate itself and whether it could obligate the alleged principal. The Court placed great emphasis on the fact that the contract specifically provided that the taxpayer "is and shall be deemed to be an independent contractor and not the agent or employee of OWNERS or ALYESKA." 674 P.2d 260. The Court recognized that a contract provision regarding the relationship between parties is "not always effective to alter the true nature of that relationship." This is consistent with the Taxpayer's reliance on other cases in which an agency relationship was determined by the Court although not expressly stated in the contracts. However, the Court went further and explained that the provision was a "clear manifestation" that Alyeska did not consent to the taxpayer acting as its agent. *Alabama v. King and Boozer*, 314 U.S. at 13. In *Green*, the Court further explained that agency did not exist because "[t]he taxpayers also have not provided any

evidence to support their position that Alyeska authorized the taxpayers to create contractual obligations with third parties that would be binding upon Alyeska" or that "Alyeska manifested its consent to the taxpayers acting as its agents."

In the present case, all of the contracts state that the Taxpayer was an independent contractor. F.F. 67. Contract 4834 additionally specifies that the Taxpayer is not an agent or employee of ARCO. F.F. 67. As the Audit Division points out, at no point in this appeal has any evidence been presented by ARCO or on its behalf that it intended the Taxpayer to serve as its agent. ADR at 4. Rather, the contract provisions state the contrary, restricting the Taxpayer from obligating ARCO through the Taxpayer's purchases:

> . . . neither the funding of said zero balance bank account nor acceptance of subsequent invoices to the account for such funding shall preclude the right of ARCO to thereafter dispute any of the items invoiced and shall not be construed as acceptance of any part of the services.
>
> * * *
>
> . . . contractor's invoices may be adjusted by ARCO for any reimbursable item invoiced by Parsons when such item is not adequately supported or for invoice items not reimbursable as set forth in Exhibit C. Such adjustment may be deducted from the amount of the contractor's next advance funds disbursement from the zero balance bank account.

Tr. 91; Part 2(b) (Ex. 15) of Contract 6000.

One can be an independent contractor and an agent. However, the above quoted contract provisions make it clear that the agency requirement that the principal manifest

the agent's right to act on its behalf is not only absent in the present case but contrary to these provisions.

The purchase order forms do not convey an agency relationship. The form is clearly a form of the Taxpayer, listing the Taxpayer's name, its logo and addresses at the top of the form. Additionally, throughout the form, reference is made to the Taxpayer. The form states that the item is to be shipped to the Taxpayer, but does list the address as "c/o Atlantic Richfield Company". Ex. C. The Taxpayer has not stated, nor is it likely to occur, that if a non-reimbursable item is purchased using the purchase order forms that a vendor could collect against ARCO. This fact was a focus of the Court's holding against agency in *Green* and *United States v. New Mexico*.

Therefore, it is clear from the facts and the pertinent case law that the Taxpayer was not the agent of ARCO for Alaska income tax purposes.

II. The Taxpayer's Home Office Engineering Services Performed Outside Alaska Do Not Constitute A Separate Income-Producing Activity Whose Gross Receipts Should Be Excluded From The Alaska Sales Factor Numerator.

The Taxpayer argues in the alternative that if it is determined that its gross receipts from the procurement of materials are includable in the Alaska sales factor, the gross receipts from its personal services provided outside Alaska should not be included in the Alaska sales factor because they constitute a separate income-producing activity. Ex. 2 at 294-95; Ex. 11 at 3; Ex. 12 at 13; Tr. 33, 74-76; TPB at 86-101. The Taxpayer claims it conducted two income-producing activities under the Alaska contracts at issue: service activities, including design, engineering, and architectural services performed at its home office; and construction activities, including construction management, construction service, and procurement of materials. It maintains that the design, engineering, and architectural

services were separate income producing activities because they could be segregated under the contract, function distinguishably from the remaining contract work, and were separately profitable. The Taxpayer claims ARCO was looking to Parsons for completion of various phases of the project. The initial phase of the contracts involved design, engineering and architectural services performed in California, with California employees who did not leave the facility except for a few who went to Alaska. Tr. 103. If ARCO determined that it was not economically feasible to construct the project after this phase, it claims ARCO could have terminated the project. ARCO held a property interest in the work product through patents. Therefore, the Taxpayer contends it could have constructed the modules through other contractors. Ex. 2 at 267, 271; Ex. 11 at 3; Tr. 80; TPB at 95. It claims that this is exemplified by the 30-day termination clause which ARCO could have exercised at any time during any phase of the contract. Tr. 80; TPB at 94-95, 97. Payment would have been received for its design, engineering, and architectural services, and profit would have been based on those separate activities. TPB at 94-95; Tr. 75-76. The Taxpayer supports its position by citing 15 AAC 19.301(d)(2). Tr. 75-76; TPB at 87. It maintains this provision clearly provides that if two profitable activities exist that are conducted in two different states, each is separately taxable.

The Taxpayer argues that the receipts attributable to the design, engineering, and architectural should be allocated according to the rules regarding personal services sales, AS 43.10.010, Art. IV, ¶¶ 6 and 17 and 15 AAC 19.301(d)(2), and not AS 43.10.010, Art. IV, ¶ 16 which relates only to the sale of tangible personal property. Tr. 33, 75, 83; TPB at 6-7, 86-87. Under AS 43.19.010, Art. IV, ¶ 17 and 15 AAC 19.301(d)(2), sales of other than tangible personal property are attributable to Alaska only if the income producing activity is performed both in and

outside Alaska, and the greater portion of the income producing activity is performed in Alaska, determined according to the cost of performance. Based on these provisions, it proposes that allocation for personal services must be done according to labor hours where the personal services are performed. It therefore contends that its gross receipts attributable to its design, architectural and engineering services should be attributed to California where the services were performed. The Audit Division's method of calculating the sales factor is challenged as artificially increasing the Alaska sales factor and the Taxpayer's share of Alaska taxable income by "boot strapped" gross receipts from separate income producing activities. TPB at 98. The Taxpayer refers to a number of Arizona transaction business tax cases in which the courts separated the gross receipts between the design and construction phases. TPB at 89-93, 99; Tr. 80-81. It claims that it is a common accounting technique to determine income based on separate contract phases. It cites the IRS's position that design, engineering and construction activities of a construction contractor must be segregated from its other activities because the long-term accounting method can not be employed for those types of activities. Ex. 11 at 4; Ex. 12 at 17; Tr. 80-81; TPB at 92-93, 99. See Treas. Reg. ¶ 1.451-3; Letter Rulings 8138138, 8109015, and 8203010. The Taxpayer claims its deficiency as only $184,687 in taxes, plus interest. Ex. 11 at Attachment 3; Ex. B; Tr. 33. It explains that it has already paid a large portion of this deficiency. Tr. 33.

The Taxpayer maintains the Audit Division allocates all the contracts' gross receipts to Alaska because it misfocuses on the contracts containing both service and construction activities in the same documents. Tr. 76. It also disagrees with the emphasis the Audit Division places on the fact that the contracts ultimately call for the delivery of the property to the jobsite in Alaska. Tr. 76. It maintains the focus

should be on the separate profitability of the service and construction activities. The Taxpayer further objects to what it characterizes as a very aggressive position by the Audit Division, that even if the service phases of the contracts had been executed as separate contracts, it would still have allocated all gross receipts from all the contracts to Alaska because the ultimate object of the contracts was the delivery of the modules to Alaska. Tr. 84. The Taxpayer again cites the Arizona cases involving a transaction privilege tax as support for its position. See Ariz. State Tax Comm'n v. Holmes and Narver, Inc., 548 P.2d 1162 (Ariz. 1976); Ebasco Services, Inc. v. Arizona Tax Comm'r, 402 P.2d 423 (Ariz. 1965). Tr. 98-99; TPB at 89-92. These cases hold that the substance, not the form of the contract, governs. The Taxpayer further relies on Ak. Rev. Dec. 80-11 (June 3, 1980), claiming it supports its position that clearly-identifiable phases of a contract represent separate income-producing activities. Tr. 99. That decision held that if the engineering phase of the taxpayer's contract had been in a separate contract, the gross receipts from that phase of the taxpayer's activities would not have been includable in the sales factor for it would have been a separate-income producing activity.

The Audit Division maintains that Ak. Rev. Dec. 83-38 involving the Taxpayer in the present case adequately and correctly addressed the issue raised here. Ex. 12 at 10-11. It characterizes the Taxpayer's objections as based on a substance versus form type of analysis. It contends that only the State can make this type of argument, recharacterizing or re-casting a transaction. Tr. 9. The Audit Division contends that there is no practical way to break out the design, engineering and architectural phases and the construction and procurement phases, maintaining that the point of the contracts was delivery of a completed finished product to Alaska. Ex. 12 at 15; Tr. 79. It points out that the various phases of work were all contained in

one contract. It maintains the evidence does not demonstrate that ARCO would have been willing to contract on a piecemeal basis. Rather, it contends logic dictates that ARCO would expect a high degree of certainty that the Taxpayer would complete a project of this magnitude once it was undertaken. The suspension and termination provisions are viewed by the Audit Division as expected escape clauses inserted in the contracts, reflecting good business judgment by a prudent business. Ex. 12 at 15-16. It emphasizes that these contracts were not terminated. Ex. 12 at 16. The Audit Division summarizes why it characterizes the gross receipts from the Taxpayer's various activities as part of one activity - the sale of tangible personal property, in its reply to the Taxpayer's Points and Authorities, ADR at 3:

> While a contractor renders a skill in performing pursuant to a construction contract, *the objective of the undertaking is to construct and deliver tangible personal property*. Therefore, the contract is characterized as one for the sale of tangible personal property for purposes of the sales factor.

The Audit Division justifies including all the gross receipts from the contracts in the Alaska sales factor numerator:

> In assigning the sales factor on these contracts exclusively to Alaska, credit is given for the fact that it was the economic setting where the value for the work performed was realized.

Ex. 4 at 21; Ex. 2 at 64. It explains that the sales factor is to reflect "the value of the market place in the scheme of the transactions and activities involved in generating a profit". Ex. 4 at 21. The Audit Division maintains that if a taxpayer could divide its activities into numerous components which it claims generated the gross receipts, a limited and unrealistic value would exist regarding the

actual sales transaction. Ex. 4 at 21; Tr. 88. The actual gross receipts attributable to the sale would become artificially deflated. It maintains that the property and payroll factors effectively attribute a fair share of the Taxpayer's income to the income-producing activities performed outside Alaska.

The Audit Division also attacks the probative value of the federal revenue rulings and letter rulings cited by the Taxpayer. Ex. 12 at 18-21. It points out that the taxpayers mentioned in these documents were not required to actually construct, build, or install anything. Therefore, they were not allowed to use the long term method of accounting. In the present case, the Taxpayer was actively involved in construction. Thus, the Audit Division concludes that the cited revenue rulings and letters are not supportive of the Taxpayer's position, but rather support the Audit Division's position which distinguishes between contractor's services that only involve design and contractor's services which include design and construction activities.

The Audit Division further attacks the Taxpayer's argument that the separate profitability of the contract phases constitute separate taxable activities as advocating a value added tax. Ex. 12 at 12-14. Under a value added tax methodology, a tax is generally levied on only the value added to the goods from the point of extraction of raw materials through the manufacturing and distribution process to the final point of sale. The sum of these values added at all stages theoretically equals the retail selling price. It maintains this form of bifurcation has problems. Ex. 12 at 14; Tr. 88-89. For example, it cites the regulations and litigation involving I.R.C. ¶ 482 as authority for its position. That provision attempts to establish criteria for determining the fair market value of uncontrolled sales between related parties. The Audit Division maintains that under the Taxpayer's position, the

Audit Division would be placed in this same position of attempting to determine the real value of transactions. It maintains that it would be administratively burdensome to require the State to look at every transaction to determine all the various separable phases when the entire point of the contract is a product for Alaska. It emphasizes that this would defeat the statutory goal of the Alaska income tax provisions, simplicity of administration.

The Audit Division does not dispute the fact that there are some accounting methodologies which can separate a sale into various components. Tr. 87-88. However, it maintains that this methodology is inappropriate here. In fact, it contends the income tax statutory provisions not only do not require this approach, but prohibit it. Ex. 12 at 15; Tr. 89. It claims that it would be contrary to AS 43.19.010, Art. IV, ¶ 16, requiring allocation of sales receipts to Alaska if the property is shipped or delivered to a purchaser within the state. This provision would be meaningless if the gross receipts from sales were segregated under the accounting method proposed by the Taxpayer. An administrative repeal of this statutory provision would result. The Audit Division further contends the Taxpayer's position leaves meaningless the distinction between sales of tangible personal property and other sales, found in AS 43.19.010, Art. IV, ¶ 16 and ¶ 17. Ex. 12 at 16. If the contract had ended when the engineering stage was completed, there would not have been a sale of tangible property. It maintains this is the scenario contemplated by AS 43.19.010, Art. IV, ¶ 17, where no sale would have occurred attributable to Alaska.

The Taxpayer suggests instead that an administrative nightmare would occur under the Audit Division's analysis. Ex. 11 at 4; TPB at 98. It explains that if its design modules were sent to two different states, it would be impossible to allocate the gross receipts under the Audit

Division's methodology. Additionally, it contends a nightmare would be created if the contract was terminated after the engineering stage, but years later the Taxpayer agreed to procure the materials and construct the modules. Ex. 11 at 4. Under the Audit Division's analysis, it claims the gross receipts from the early engineering stage would have to be combined. The Taxpayer further claims that even if separation of gross receipts does create an administrative nightmare, the law requires the segregation and therefore no option exists but that the Audit Division follow the law. TPB at 96.

The Taxpayer also refutes the Audit Division's accusation that it is seeking a value-added type of taxation. Tr. 96-97. It simply maintains there are only two phases involved here. It disagrees that the pertinent laws do not require this type of analysis.

Ak. Rev. Dec. 83-38 addresses many of the arguments raised here. The decision held that the contract provisions were integrated and not separate personal service contracts, ultimately requiring the delivery of tangible personal property. The Taxpayer's additional arguments, new facts, and exhibits introduced during this appeal period do not justify changing that holding.

The Taxpayer's arguments regarding what should be included in the sales factor revolve around the issue whether "separate income producing activities" occurred in different states. The Taxpayer's authority for this inquiry is 15 AAC 19.301 where this term is found. TPB at 87-89, 93. See also AS 43.19.010, Art. IV, ¶ 17. The Taxpayer's inquiry is premature and misinterprets the basic test defining what gross receipts are allocable to the Alaska sales factor. The issue under the income tax statutes and regulations regarding which gross receipts are allocable to the Alaska sales factor numerator is whether sales of tangible personal property or sales of non-tangible personal

property occurred. AS 43.10.010, Art. IV, ¶¶ 16-17; 15 AAC 19.251; 15 AAC 19.281; 15 AAC 19.301. Only if sales of non-tangible personal property occur does the "separate income producing activities" in different states inquiry become relevant under AS 43.19.010, Art. IV, ¶ 17 and 15 AAC 19.301. This is because AS 43.19.010, Art. IV, ¶ 17 and 15 AAC 19.301 concern sales allocation of gross receipts when sales of non-tangible personal property are involved. AS 43.19.010, Art. IV, ¶ 16 and 15 AAC 19.281 address the allocation of gross receipts from sales of tangible personal property. Gross receipts from the sale of tangible personal property are allocable to the destination state under these provisions.

Therefore, the first inquiry must be whether the Taxpayer was involved in sales of tangible personal property or sales of non-tangible personal property. The Taxpayer and the Audit Division characterize the activities at issue here differently. The Taxpayer's characterization of its activities is that the service and construction activities are separate. The Audit Division's characterization is that the various activities of the Taxpayer, including its design, engineering, architectural, construction, construction management and procurement services, are integrated, specifically contracted for in order to produce environmental modules to be used in Alaska. The Audit Division distinguishes the contracts at issue here with the Alaska project contracts which only required design, engineering and other similar services occurring outside Alaska. The contracts involving only design, engineering and similar services performed outside Alaska were determined to involve sales of non-tangible personal property. The contracts at issue here were determined to involve sales of tangible personal property. It is clear that the Audit Division has already distinguished between the different activities of the Taxpayer and properly

characterizes the nature of the contracted activities at issue here as involving sales of personal tangible property.

The ability to segregate the contract into phases that are functionally distinguishable from the remaining contract work and are separately profitable does not justify bifurcating the contract and allocating the gross receipts to separate states under Alaska law. These factors do not negate the fact that all phases of the contracts were directed at producing a product, environmental modules for installation in Alaska. Procurement of materials and equipment to produce the modules was an integral part of each phase of the contracts. No other use or marketability of the product existed except as part of the system in Alaska. Ex. 2 at 252, 256. The Taxpayer was responsible for the over-all management of the project directly through its services and indirectly through its subcontractors.

These factors distinguish this case from the type of contract discussed in Ak. Rev. Dec. 80-11 in which truly separate unintegrated activities existed. The termination provisions do not make the contracts at issue here the same as the service contracts whose gross receipts were not included by the Audit Division in the sales factor numerator. The contracts at issue here are also clearly distinct from the other contracts of the Taxpayer where no activities beyond the design, architectural and engineering services were contracted for. If the termination option was exercised, then the contracts' gross receipts would have been treated like the service contracts' gross receipts. ADR at 4-5. However, it is clear in the present case that the contracts at issue were not terminated before completion.

What the Taxpayer is proposing is simply an alternative accounting method to allocate its income. Just because other taxing jurisdictions segregate activities in imposing taxes does not mean that such a procedure should be followed in Alaska. The Taxpayer's cited authorities are

also not relevant as to how Alaska income tax provisions require reporting income since they involve distinctions made by other states concerning different types of taxes which have a different tax incidence, and IRC provisions regarding the timing of recognizing income and expenses and not whether the income is taxable. See Ex. 12 at 20-23, 25. Even if this method is "easy and accurate" as the Taxpayer claims, or even "fairer", does not mean that the Taxpayer has met its burden of proof by "'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in [the] state', or has 'led to a grossly distorted result'". *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 180-81 (1983); *Sjong v. State of Alaska, Dep't of Revenue*, 622 P.2d 967, 976-78 (Alaska 1981), *appeal dis'm*, 454 U.S. 1131 (1982); Moorman Mfg. Co. v. Bair, 437 U.S. 267, 274 (1978); *Norfolk and Western Ry. Co. v. North Carolina*, 297 U.S. 682, 688 (1936). An apportionment formula which applies a "rough approximation rather than precision" in determining what income is attributable to the state is sufficient. *Int'l Harvester Co. v. Evatt, 329 U.S. 416,* 422 (1940); *Sjong v. State of Alaska, Dep't of Revenue*, 622 P.2d at 976.

As stated in Ak. Rev. Dec. 83-38 at 9-10, the Alaska income tax sales factor's focus is on the market place. Gross receipts from the sale of tangible personal property are assigned to the market destination state in order to give value to the economic environment in which the income was realized because of the sale. Gross receipts from sales of services are less tangible as to the buyer's market place but can clearly be identified as to the state where the production occurred. However, where personal services culminate to produce a tangible product delivered to a reasonably identifiable buyer's market place, Alaska law requires allocating the gross receipts to the market place state in the sales factor. The property and payroll factors

reflect the state where the underlying activities occur, the value of the property and labor which produced the product. Thus, the income tax three-factor apportionment formula recognizes and assigns values to the various aspects of a business where the income was generated. The allocation of the contracts' gross receipts in the numerator of the sales factor of a three-factor formula under the income tax provisions is justified.

III. The Inclusion Of The Gross Receipts From The Procurement Of Materials And The Home Office Engineering In The Alaska Sales Factor Does Not Violate The Due Process And Commerce Clauses Of The U.S. Constitution.

The due process and commerce clauses prohibit a state from taxing income earned outside its borders. U.S. Constitution, Art. I, ¶ 8, cl. 3, Amendments, Article 14; *Northwestern States Portland Cement Co. v. Minn.*, 358 U.S. 450, 462 (1959); *Sjong v. State of Alaska, Dep't of Revenue*, 622 P.2d at 975. However, due to the complex nature of business transactions, it is often difficult to separate what income of a multistate corporation is attributable to each state because profitability arises from the operation of a multistate business as a whole without a single identifiable source. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 438 (1980); *Exxon Corp. v. Wisc. Dept. of Rev.*, 447 U.S. 207, 219 (1980); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 282 (1924); *Earth Resources v. State of Alaska, Dept. of Rev.*, 665 P.2d 960, 966 (Alaska 1983). Apportionment formulas have been created in order to solve this dilemma and roughly approximate the corporate income "reasonably related to the activities conducted within the taxing State". *See Exxon*, 447 U.S. at 223. Apportionment formulas must adhere to constitutional

constraints under the due process and commerce clauses. In *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977), the U.S. Supreme Court set out a four prong test for determining the validity of a tax under the constraints of the commerce clause, whose first and fourth prongs describe due process requirements:

1. There must be a minimal connection or sufficient nexus between the taxed activity and the taxing state;
2. The tax must be fairly apportioned between the taxpayer's in-state and out-of-state activities;
3. The tax cannot discriminate against interstate commerce; and
4. The tax must fairly relate to the benefits and services provided by the taxing state.

See also Mobil Oil Corp v. Comm'r of Taxes, 445 U.S. at 436-37; *Central Greyhound Lines v. Mealey*, 334 U.S. 653, 661 (1948); *Sjong v. State of Alaska, Dep't of Rev.*, 622 P.2d at 973.

In *Container Corp. v. Franchise Tax Bd.*, 433 U.S. at 169, the Court emphasized that the due process and commerce clauses require that apportionment formulas must be fair. One test of fairness in an apportionment formula is that internal consistency must exist:

> The first, and again obvious component of fairness in an apportionment formula is what might be called internal consistency - that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary businesses' income being taxed.

Container Corp., id.; TPB at 102.

Alaska requires taxpayers to apportion and allocate income based on a three factor formula of sales, property

and payroll. AS 43.19.010, Art. IV.; 43.20.065. Three factor formulas based on sales, property and payroll have been upheld as constitutional by the Courts in a number of decisions, including *Container*, *Mobil*, *Exxon*, *Butler Brothers v. McColgan* 315 U.S. 501 (1942), and *Earth Resources*. The U.S. Supreme Court made in clear in *Moorman Mfg. Co. v. Bair*, 437 U.S. at 274 that states have "wide latitude in the selection of apportionment formulas". *See also Sjong v. State of Alaska, Dep't of Revenue*, 622 P.2d at 976. The burden of proof in challenging the State's allocation of income is upon the taxpayer. Formula-produced assessments will only be disturbed when the taxpayer meets its heavy burden of proof. To show unfair apportionment, the taxpayer:

> must demonstrate that "there is no rational relationship between the income attributed to the State and the intra-state values of the enterprise" . . . .

Container Corp. v. Franchise Tax Bd., 463 U.S. at 180-81. As mentioned previously, the Taxpayer must show by "'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in [the] state, or has 'led to a grossly distorted result'". *Container*, *id.*; *Sjong v. State of Alaska, Dep't of Revenue*, 622 P.2d at 976-77; *Moorman Mfg. Co. v. Bair*, 437 U.S. at 274; *Norfolk and Western Ry. Co. v. North Carolina*, 297 U.S. at 688 (1936).

The Taxpayer contends the imposition of an Alaska income tax on California home office engineering activities clearly violates the third and fourth factors of the *Complete Auto* test. Ex. 11 at 6; TPB at 103; Tr. 85. Concerning the third factor, it maintains that Alaska is taxing income earned outside its borders by including the gross receipts attributable to its home office's engineering and procurement services in the Alaska sales factor. TPB at 85, 101-02. It argues that more taxable income is attributable

to Alaska than can be reasonably allocated to the State. It claims that double taxation has occurred because the gross receipts from home office engineering services included by the Audit Division in the Alaska sales factor numerator were also included in the California sales factor numerator. F.F. 68; Ex. 11 at 6; TPB at 104. It paid California income taxes based on those values. As far as the fourth factor, it claims that under the Audit Division's analysis, home office engineering services performed in Alaska and destined for another state would be includable in the Alaska numerator of the sales factor. Ex. 11 at 6; TPB at 102, 105. Therefore, it claims that intrastate activities would be favored to the detriment of out-of-state activities. The Taxpayer's arguments concerning the alleged violation of the fourth factor are based on its claim that the internal consistency test is violated.

The Audit Division contends the factors are not violated. Tr. 101; ADR at 5. It contends that the Taxpayer has relied on cases involving single factor gross receipts formulas in its challenge against the three factor apportionment formula for income tax purposes. It maintains that it is the Taxpayer's burden to prove that the Alaska formula is at fault if double taxation occurs. It emphasizes that the Taxpayer has not attempted to meet this burden. It additionally contends that double taxation should not occur because the Alaska tax formula is internally consistent. ADR at 5. It emphasizes that the Taxpayer has misapplied the internal consistency test. It maintains that the test looks at what result would occur if every state applied the same formula as the taxing state. It states that in the present case, that would result in no more than all the unitary business income of the Taxpayer being taxed.

A. Fair Apportionment

It is well established that the income of a business operating in interstate commerce is not immune from fairly

apportioned state taxation. Mobil, 445 U.S. at 436; *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. at 458-62; *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 130 (1920). Fair apportionment does require avoiding multiple taxation. *Washington Telephone Co. v. State*, 468 P.2d 687, 690 (Wa. 1970). It is the taxpayer's burden to prove that multiple taxation has occurred. *Scott v. Williams, Inc. v. Bd. of Taxation*, 372 A.2d 1305 (N.H. 1977). A taxpayer need not demonstrate actual multiple taxation to prevail under a commerce clause challenge if the tax is discriminatory on its face. *Armco Inc. v. Hardesty*, 467 U.S. 438 (1984); *Alyeska Pipeline Service Co. v. Williams*, 687 P.2d at 331. However, if the tax is apportioned under a non-discriminating statute, the taxpayer's demonstration of a risk of "overlapping taxation" may not demonstrate a violation of the commerce clause. *Alyeska*, *id.* Constitutional protections do not prohibit all overlap of taxable income in the computation of the states' apportionment formulas. *Moorman Mfg. Co. v. Bair*, 437 U.S. at 278-79. Such evidence is relevant but not dispositive of the constitutional validity of the tax. *Alyeska Pipeline Service Co. v. Williams*, 687 P.2d at 331.

The Audit Division cites three Alaska cases to support its position that fair apportionment has occurred. In *Sjong*, the U.S. Supreme Court approved the allocation of 100% of the taxpayer's gross receipts from sales of crab in the Alaska sales factor numerator, although the crab was caught in waters outside Alaska's boundaries. In *Alyeska*, the funds from a zero balance bank account for reimbursement for costs of goods to suppliers and contractors outside Alaska for goods delivered outside Alaska were Alaska gross receipts since the object of the goods and services was construction of a pipeline in Alaska. The Alaska Supreme Court stated:

> Given that the sole purpose of Alyeska's existence was to build the TAPS, and that all of Alyeska's receipts were reimbursements for expenses incurred in the planning and execution stages of that project, we hold that the taxes imposed on Alyeska by the Department did not violate the "fair apportionment" test of the commerce clause.

687 P.2d at 331. In *State, Dep't of Revenue v. Northern T.V., Inc.*, 670 P.2d 367 (Alaska 1983), the receipts from non-Alaska broadcasting companies were held to be Alaska receipts because they were based on the in-state activity of broadcasting television programs. These cases hold that gross receipts should be attributed to the state where the object of the taxpayer's activities were centered. *See also* Ak. Rev. Dec. 83-16 (May 31, 1983) at 24-26 (Contractor's gross receipts received through a zero-balance bank account for payment for out-of-state construction and shipping of materials and equipment destined for Alaska were fairly apportioned to Alaska); Ak. Rev. Dec. 83-15 (May 6, 1983) at 45-47 (Gross receipts received through a zero-balance bank account for payment for steel procurement and transport destined for Alaska were fairly apportioned to Alaska).

Based on these cases and the facts in this case, it is evident that all of the Taxpayer's activities were centered on the creation of environmental modules specially designed for use in Alaska. Therefore, fair apportionment occurs by attributing the gross receipts from the sales of the modules to Alaska.

Whether attributing the gross receipts from the home engineering services resulted in double taxation is questionable. Just because a taxpayer pays a tax in another state based on the same gross receipts listed in one of the three factor's numerators does not mean that double taxation occurred. *See Moorman Mfg. Co. v. Bair*, 437

U.S. at 278-79; *Alyeska Pipeline Service Co. v. Williams*, 687 P.2d at 331. It also does not mean that Alaska improperly imposed a tax. 15 AAC 19.101 and 15 AAC 19.111 provide that if a taxpayer incorrectly files and pays a tax in another state when not required to do so by the laws of that state, no multiple taxation occur. According to Alaska law, the Taxpayer should not have paid California tax based on these values. Alaska and California both have adopted the Multistate Tax Compact regarding imposition of state income taxes on multistate corporations. Many of the provisions are identical or at least similar. The Taxpayer has not demonstrated that California law requires the same gross receipts to be included in the California sales factor numerator.

The Taxpayer has been taxed based on its activities related to Alaska. The Taxpayer has not demonstrated that extraterritorial values have been taxed. Any double taxation that has occurred is not based on the improper imposition of an Alaska tax, but the Taxpayer's incorrect interpretation of taxing laws. The Taxpayer should appeal to California, not Alaska, to correct this situation.

B. Intrastate Commerce Is Not Favored over Interstate Commerce.

The Taxpayer's claim that the fourth prong of the *Complete Auto* test has been violated by including the gross receipts from the home office services in the sales factor numerator relates to its position that Alaska's apportionment formula is not internally consistent. The Taxpayer admits that if every state applied Alaska's method of taxing home office engineering, double taxation would not occur. Ex. 11 at 6; Ex. 12 at 57. Thus, the Alaska apportionment formula would result in no more than all of the unitary business income of the Taxpayer being subject to tax. However, it maintains Alaska's method of taxation is more aggressive than other states. Ex. 11 at 6; Ex. 12 at

57; TPB at 103.. It contends that if it had conducted its engineering services in Alaska for a product destined for another state, Alaska would require its gross receipts paid for such services to be included in the Alaska numerator of the sales factor.

The Audit Division's characterization of whether it would impose a tax on such services differs from the Taxpayer's interpretation of Alaska law. Ex. 12 at 57; ADR at 4-5. The Audit Division contends that since the product is destined for sale in another state, the gross receipts from such services would not be included in the Alaska sales factor numerator. The Audit Division also explains that if the Taxpayer here had not completed its contracts beyond the home office services performed in California, the contracts' gross receipts would not be apportioned to Alaska. Tr. 104. The Audit Division views the gross receipts in such a situation as subject to California taxation.

It is clear that the Audit Division is consistent in allocating gross receipts from engineering services performed in another state to the state where the product is destined. If the product is never developed beyond the design and engineering stage and is not delivered to the destination state, the Audit Division clearly states that the gross receipts from those services would be allocated to the state where the services were performed. Tr. 104; ADR at 4-5. This is also a consistent application of multistate tax law. No discrimination of intrastate commerce over interstate commerce has been demonstrated. The allocation of the Taxpayer's gross receipts to Alaska appears fair. As the Alaska Supreme Court explained in *Alyeska Pipeline Service Co. v. Williams*, 687 P.2d at 331, citing *Container*:

> At least in the interstate commerce context . . . the anti-discrimination principle has not in practice

required much in addition to the requirement of fair apportionment.

IV. The Taxpayer Has Failed To Show That The Allocation And Apportionment Provisions Of Article IV Do Not Fairly Represent The Extent Of The Taxpayer's Business Activity In This State; Therefore, The Commissioner Will Not Modify The Sales Factor.

The Taxpayer has requested the Commissioner of Revenue to modify the sales factor pursuant to AS 43.19.010, Art. IV, ¶ 18. Ex. 11 at 7; Tr. 86. Under that provision a Taxpayer is permitted to petition the Commissioner for the application of separate accounting, the exclusion of one or more of the factors, the addition of additional factors, or the employment of some other method which effectuates an equitable allocation and apportionment of income. AS 43.29.010, Art. IV, ¶ 18. Prior to the exercise of the Commissioners discretion, there must be a finding that the "allocation and apportionment provisions of [Article IV] do not fairly represent the extent of the taxpayer's business activity in this state." *Id.*

The Taxpayer makes several claims which allegedly demonstrate that the existing sales factor distorts the extent of its business activity in Alaska. The Taxpayer alleges that some of its income is being doubly taxed because of the inclusion of the same engineering receipts in the numerators of Alaska and California. Ex. 12 at 6. In other words, the Taxpayer is claiming Alaska is taxing income already taxed in another state. However, the standard for measuring the fairness of a particular formula is not examining how other states tax a particular taxpayer. Rather, the fairness of each state's method is determined on the basis of the internal and external consistency of its method. *Container*, 463 U.S. 159, 169, 77 L.Ed.2d 545, 556. Since the three factor formula applied to this Taxpayer is virtually the same as that approved by the U.S. Supreme Court in *Butler Bros. v*

McColgan, 315 U.S. 501, 86 L.Ed. 991 (1941), we may not substitute another method of allocation and apportionment without proof that the present provisions do not reflect the extent of the Taxpayer's business activity in this state.

Were the internal and external consistency standards of review set aside in favor of a method whereby each state waited to see how other states were taxing a particular taxpayer, chaos would most certainly result. The first state imposing a tax would affect all others; any change in one jurisdiction would have a potential domino effect in all of the other jurisdiction. The internal and external consistency standard of review avoids such chaos and authorizes the method of allocation and apportionment which results in a "rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing state." *Atlantic Richfield Co. v. State*, 705 P.2d 418, 423 (Alaska 1985), *quoting Moorman Mfg. v. Bair*, 437 U.S. 267, 273, 57 L.Ed.2d 197, 204 (1978).

Compare the situation of the Taxpayer in this case, who is asserting distortion based on the alleged double taxation, to the tax formerly imposed under AS 43.21. The Alaska Supreme Court upheld the separate accounting method imposed under that chapter after finding that the traditional formula apportionment method inadequately reflected the phenomenal value of the companies' oil reserves in Alaska. The court showed the situation of Sohio as an example. Sohio had only 10% of its payroll, 12% of its sales, and 50% of its property in Alaska, but over 90% of its oil production was from this state. *Atlantic Richfield* at 428. This Taxpayer has failed to demonstrate a similar distortion in its Alaska income as determined under the traditional formulas.

The Taxpayer also asserts that the value of materials procured as ARCO's alleged agent is not probative of the

Taxpayer's Alaska income. However, this claim is without foundation. In section I of this decision we determined that the Taxpayer failed to prove that it was ARCO's agent or trustee. *Supra*, at 29-37.

DECISION

1. The Taxpayer's design, engineering, architectural, construction management and procurement services were provided to produce a product to "sell" and deliver to Alaska customers. Under Alaska income tax laws, the gross receipts from those services are includable in the Alaska sales factor numerator and denominator. The Taxpayer was not acting as an agent or trustee of ARCO in performing those services.

2. The Taxpayer's gross receipts from its home office engineering services performed outside Alaska were not earned from separate income producing activities and therefore should be included in its Alaska sales factor numerator.

3. The inclusion of the gross receipts from the procurement of materials and the home office engineering in the Alaska sales factor does not violate the due process and commerce clauses of the U.S. Constitution. Fair apportionment occurred. Any double taxation is due to the Taxpayer incorrectly reporting its income in California. Any relief from such taxation should be sought in California. Additionally, interstate commerce was not favorer over intrastate commerce.

4. No abuse of discretion occurred because the Taxpayer was not granted an adjustment to its Alaska sales factor.

5. The assessments are affirmed. The Taxpayer has already paid the assessments for 1977-1979. The assessments for 1980 and 1981 have not been paid. For 1980, the Taxpayer owes $309,682 in taxes and $239,329.02 interest as of January 31, 1988, accruing at $101.81 per day. For 1981,

the Taxpayer owes $203,812 in taxes and $141,205.41 in interest as of January 31, 1988, accruing at $67.00 per day.

If the Taxpayer agrees with this decision, the liability must be paid within 30 days of the date of the order of adoption. If the Taxpayer disagrees with this decision, it may, within 30 days of the date of the Order of Adoption, file an appeal in the Superior Court in the Alaska Judicial District in which it does business. If an appeal is made to Superior Court, the liability must either be paid or a supersede as bond must be filed with the Superior Court in accordance with Appellate Rule 603(a)(2). Failure to timely pay the liability or to post the supersede as bond may result in enforced collection action which may include the filing of tax liens and/or seizure of assets to satisfy the liability.

Dated at Juneau, Alaska this 5th day of July, 1988.

s/s Theresa Hillhouse

Theresa Hillhouse

Revenue Hearing Examiner

ORDER OF ADOPTION OF DECISION OF HEARING OFFICER

I, Hugh Malone, Commissioner of Revenue, under the authority of AS 43.05.010 order that the attached decision relating to the appeal of the corporate income tax assessment against the Ralph M. Parsons Company and The Parsons Corporation [collectively referred to as "Parsons"], be adopted and entered in the Taxpayer's files as of this date as the final administrative determination in this matter.

This decision was prepared by Theresa Hillhouse, who was duly appointed, pursuant to the provisions of AS 44.17.010 and AS 44.25.010 as Hearing Officer, to hold a hearing, consider the argument and evidence presented in this appeal and to recommend a decision in this matter.

This order is dated at Juneau, Alaska this 5th day of July, 1988.

/s/ Hugh Malone

Hugh Malone

Commissioner Revenue

APPENDIX E

IN THE SUPREME COURT OF ALASKA

Case No. S-4137

STATE OF ALASKA, DEPARTMENT OF REVENUE

Appellants

vs.

THE PARSONS CORPORATION AND
THE RALPH M. PARSONS COMPANY

Appellees

PETITION FOR REHEARING OF SUPREME COURT
DECISION NO. 3899
DATED NOVEMBER 20, 1992

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Filed _ , 1992
Supreme Court of Alaska
By: _____
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Jurisdiction Statement

This is a motion for rehearing filed under Rule 506, Rehearing, Rules of Appellate Procedure.

1. The opinion overlooked, misapplied or failed to consider the controlling question in this case -- whether Parsons was ARCO's agent.

The opinion does not analyze the agency issue, the core of the parties' dispute. The DOR and Parsons from the outset have disputed whether Parsons was ARCO's purchasing agent (and sold services); and recognized that agency is inconsistent with Parsons selling property to ARCO. Decision No. 88-67 (at 35) and the Superior Court analyzed agency at length recognizing that agency was the primary issue.

In holding that Parsons sold property, the opinion did not discuss why Parsons was not ARCO's agent and failed to examine any cases or facts upon which the Superior Court relied to find Parsons was ARCO's agent and did not sell property; or upon which the Hearing Officer relied to find Parsons was not ARCO's agent.

An articulated analysis of the relationship between Parsons and ARCO would have consequences far beyond taxation. ARCO can buy property from Parsons or hire Parsons as an agent to purchase property on its behalf. The rights and duties of ARCO and Parsons vary considerably depending upon whether Parsons is an agent or seller; agency affects sales, construction, environmental, and property law, etc. The opinion ignored Parsons' citation to *Green Constr. Co. v. Dep't of Revenue*, 674 P.2d 260 (Alaska 1983), *Ariz. State Tax Comm' v. Parsons-Jurden Corp.*, 449 P.2d 626 (Ariz Ct. App. 1969) and numerous other cases demonstrating that Parsons provided agency procurement services and could not sell property.

This Court agreed that the agency issue is central, characterizing the issue as follows:

> The income tax results in this case depend upon classification of Parsons' business activity. If Parsons

> acted as a manufacturer and seller of oil field modules, its revenues were for the 'sale of tangible personal property.' If Parsons acted as a contractor who *procured material as a purchasing agent and was paid for skills and services provided. its revenues were from 'sales other than sales of personal property.'* Opinion at p. 8. (Emphasis added).

It is fundamentally unfair for the opinion to rule that taxation of Parsons depends upon whether Parsons is ARCO's agent and then ignore the Superior Court's and Decision No. 88-67's agency analysis.

Furthermore, page 4 of the opinion states, "Parsons provided ... agency procurement services from its home office in California." The opinion does not reconcile its finding that Parsons provided agency procurement services with its holding that this case turns on whether Parsons is ARCO's agent. If Parsons was ARCO's purchasing agent, it could not sell property to ARCO.

2. <u>The opinion overlooked, misapplied or failed to consider a fundamental principle of law in relying on 15 AAC 1300, et seq. because DOR admits that the effective date of these regulations is after the years in question</u>.

DOR first argued these regulations on appeal from the Superior Court (DOR brief, p. 17); however, during oral argument DOR attorney Marilyn May abandoned this argument:

> [W]e are *withdrawing the argument* which is based on the specific construction contractor regulations which are found at 15 AAC 19.1300 through 1390. These regulations were not in effect during any of the tax years in question so that argument can be

> disregarded. (Copy attached, emphasis added.)

These regulations upon which the opinion relied became effective January 12, 1983, after the years in question (1978 through 1981), did not exist in any form prior to the effective date, do not apply to this case, and cannot be retroactively applied. Relying on DOR's concession, Parsons refrained from arguing that the regulations are void because they contradict the statute. The opinion ignored DOR's admission, and specifically relied upon 15 AAC 19.1300, et seq., in holding Parsons was a construction contractor taxable under those regulations.

DOR did not argue these regulations during the audit, the administrative appeals, or to the Superior Court. And, neither the Hearing Officer nor Superior Court considered these regulations. The opinion erred in applying these regulations retroactively *sua sponte*, after DOR admitted their inapplicability.

3. The opinion failed to analyze any cases defining the legal requirements of a sale of property.

Article IV. 16. requires a sale of tangible personal property and "sale" is a word of precise legal import, but the opinion ignored this requirement. "Sale" means a contract to pass right of property for money. *Thomas v. Buttress & McCellan*, 297 P.2d 768 (Cal Ct. App. 1956). Other courts interpreting identical language to AS 43.19.010, Art. IV. 16. have held that the taxpayer must sell tangible personal property before its gross receipts can be sourced under the rules applicable to sales of tangible personal property and that the taxing authority may not dispense with this basic requirement. See e.g., *Coulter Elec. v. Dep't of Revenue*, 365 So.2d 806 (Fla. Dist. Ct. App. 1978); *Lone Star Steel v. Dolan*, 688 P.2d 910 (Colo. 1983); and *Mark IV Metal Products*, CCH Cal. Rptr. Para. 400-268 [12-585.531] (Cal. St. Bd. Eq. August 17, 1982).

These cases directly bear on whether Parsons sold tangible personal property and yet were ignored by the opinion. Parsons has been denied due process of law and subjected to an unreasonable burden in respect to interstate commerce under U.S. Constitution, Art. I, section 8, Clause 3, due to the absence of articulated analysis. This opinion will be not [sic] persuasive to other courts and subject Parsons to multiple taxation.

4. The opinion overlooked misapplied or failed to consider the material facts in the record establishing that Parsons did not sell property under contracts 5600 and 6000.

The opinion ignores Parsons' and DOR's stipulated facts which control characterization of the ARCO-Parsons relationship. The stipulation covered characterization of the contracts, affidavits on contract responsibilities, job descriptions, job instructions and other facts. These items were intensely analyzed in Decision No. 88-67 and by the Superior Court, but not by the opinion.

The opinion decided that Parsons sold property without considering the following DOR stipulated facts: (1) Contracts 5600 and 6000 expressly provide Parsons is to render only services; (2) ARCO exercised absolute "control over the procurement process from requisition to final approval, including from whom, under what terms, what type, how, and where the materials were acquired." (File 1 at 18); (3) ARCO assumed all risks and insured all materials against loss or damage; (4) ARCO required its approval of almost all purchases; (5) ARCO took equitable ownership of all property and the parties accepted that all property was owned by ARCO; (6) ARCO approved appointment and removal of key Parsons employees and had approximately 200 employees at Parsons' facilities controlling Parsons purchasing; (7) ARCO required Parsons to make statements, representations and commitments on

behalf of ARCO to third party vendors; (8) ARCO could inspect materials at the vendor's plant, and the vendor indemnified ARCO for damages from the property; (9) ARCO controlled whether vendors were included on the procurement list; (10) Parsons could only use ARCO-provided money for ARCO-approved purchases; and (11) Contracts 5600 and 6000 are distinct contracts from contract 4834 requiring different services and a different relationship between Parsons and ARCO. File 1, p. 7,8.

These facts establish that Parsons rendered engineering and agency procurement services, *as found by this Court*. Opinion at page 4. The opinion ignored these facts in contradicting its own findings in concluding Parsons sold property.

5. There is no evidence that Parsons was a construction contractor.

Even assuming 15 AAC 1300, *et seq*. applied, Parsons was not a constructor under 15 AAC 1390 because Parsons never constructed a building. Furthermore, ARCO was the North Slope construction contractor because it was responsible for installation of the modules in Alaska. File 9 at 19.

6. The opinion's use of the reasonable basis standard of review failure to consider the principal issue, retroactive application of regulations, and failure to consider key facts and cases constitutes a denial of due process of law under the Federal Constitution.

Taxpayers have a right to procedural due process under U.S. Constitution, Amend. XIV, sec. 1., including impartiality. Four things have transpired in Parsons' appeal which *examined cumulatively* demonstrate that Parsons has been denied due process of law. (1) Alaska's procedure for administrative review of tax disputes inherently delegates enormous authority to the DOR. The Department, which is

an aggressive advocate, is also the adjudicator. When a formal hearing officer decision is reached, it is approved by the Commissioner of the DOR, rather than an independent authority. (2) When the above-described delegation of administrative review is combined with the use of the "reasonable basis" standard, little remains of the safeguards to be provided by judicial review. Therefore, such a "reasonable basis" standard should only be used in situations where the DOR's special expertise is demanded. The present case is not one of those situations.

The controlling issue is agency, an area of the law for which DOR has no special expertise. The parties agreed that the independent standard of review is the appropriate standard for the agency issue. DOR Brief p. 13. There is nothing specialized about the agency issue here and it is an area of law particularly requiring *de novo* judicial review. Use of the reasonable basis standard amounts to ceding significant judicial review responsibilities to an executive agency. (3) The opinion relies on regulations which DOR itself concedes are inapplicable. *(4) The parties and this Court agreed that the central issue is whether Parsons is ARCO's agent.* This Court held "Parsons provided ... agency procurement services from its home office in California." Opinion p. 4. Yet, the opinion ignored facts and law cited by Parsons, its own findings and concluded without articulated analysis that Parsons income should be sourced as if Parsons sold property.

The issues considered by this Court impact every multistate taxpayer and involve a case of first impression for engineering companies like Parsons. This Court should articulate a thorough, consistent analysis of the issues. Parsons petitions this Court for a rehearing.

Dated: November 27, 1992

/s/ Lance B. Gordon
Lance B. Gordon

Patrick G.Woosley
Patrick G. Woosley

/s/ David G. Shaftel
David G. Shaftel

APPENDIX F

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

U.S. Const. art. I, § 8, cl. 3 provides:

> The Congress shall have power . . . [t]o regulate Commerce with foreign Nations, and among the several states, and with the Indian Tribes.

U.S. Const. amend. XIV, § 1 provides:

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Alaska Stat. § 43.05.150 provides:

> Collection and deposit of money.--The Department of Revenue shall demand, sue for, collect, receive, and safely keep all money of the state which is not by law entrusted to the care and custody of some other office.

Alaska Stat. § 43.05.010 provides:

> Duties of commissioner of revenue.--The commissioner of revenue shall (1) exercise general supervision and direct the activities of the Department of Revenue;
>
> . . . .
>
> (3) prescribe uniform rules for investigations and hearings;
>
> . . . .

(9) hear and determine appeals involving income, excise, license, or other taxes levied under state laws and enter orders on the appeals which are final unless reversed or modified by the court.

Alaska Stat. § 43.05.040 provides:

Inspection of records or premises and issuance of subpoenas.--(a) The department may examine the books, papers, records, or memoranda of any person to ascertain the correctness of a return filed or to determine whether a tax or a payment for oil or gas royalty or net profits shares under a contract, agreement, or lease under AS 38.05 is due, or in an investigation or inspection in connection with tax matters or matters relating to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05. The records and the premises where a business is conducted shall be open at all reasonable times for official inspection, and the department may subpoena any person to appear and produce books, records, papers, or memoranda bearing upon tax matters or matters relating to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05, and to give testimony or answer interrogatories under oath respecting tax matters or matters related to oil and gas royalty or net profits under contracts, agreements, or leases under AS 38.05, and the department may administer oaths to persons who are so subpoenaed.

Alaska Stat. § 43.05.240 provides:

(a) A person aggrieved by the action of the department in fixing the amount of tax or in imposing a penalty may apply to the department within 60 days from the date of mailing the notice required to be given to him by the department, giving notice of the grievance, and requesting an informal conference. At

the conference the person aggrieved may present arguments and evidence relevant to the amount of tax or penalty due the estate. If the department determines that a correction is warranted, the department shall make the correction.

(b) A person aggrieved by the action of the department in fixing the amount of a tax or in imposing a penalty may apply to the department and request a formal hearing

(1) in place of the informal conference provided for in (a) of this section, within 60 days from the date of mailing the notice required to be given to him by the department; or

(2) within the 30 days after decision resulting from an informal conference.

***(d) Within 30 days after the formal hearing and decision by the department, a person aggrieved by the decision of the department may appeal to the superior court in the judicial district in which he resides. The taxpayer shall be given access to the file of the department in the matter for preparation of his appeal. If after the appeal is heard it appears that the tax was correct, the court shall confirm the tax. If incorrect, the court shall determine the amount of the tax and if the person aggrieved is entitled to recover the tax or part of it, the court shall order the repayment and the department shall immediately pay the amount due and attach a certified copy of the judgment to the payment.

Alaska Stat. § 43.19.010, Art. IV provides:

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which

is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale, or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the state of the purchaser.

17. Sales, other than sales of tangible personal property, are in this state if:

(a) the income-producing activity is performed in this state, or

(b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

Alaska Stat. § 44.25.010 provides:

Commissioner of Revenue.--The principal executive officer of the Department of Revenue is the commissioner of revenue.

Alaska Stat. § 44.25.020 provides:

Duties of department.--The Department of Revenue shall

(1) enforce the tax laws of the state;

(2) collect, account for, have custody of, invest, and manage all state funds and all revenues of the state

except revenues incidental to a program of licensing and regulation carried on by another state department;

(3) register cattle brands;

(4) supply necessary clerical and administrative services for the Alcoholic Beverage Control Board;

(5) invest and manage the balance of the power development fund in accordance with AS 44.83.386.

Reg. 15 AAC 05.030. Formal Hearings.--provides:

(a) The department will hold a formal hearing if an initial request for appeal is filed in accordance with 15 AAC 05.010 and a request for a formal hearing is made. If a request for a formal hearing follows an informal conference, it must be filed within 30 days after the date the informal conference decision is issued, and must be filed with the office of the commissioner in accordance with the appeal form provided by the department. The request must state the nature of the person's objection, the relief sought, and the grounds for the objection, as required by 15 AAC 05.010(a). The request for appeal may be amended up to 30 days before the date scheduled for hearing. Amendments will be permitted after that time only if good cause is shown.

. . . .

(i) . . .Upon adoption by the commissioner, the written decision of the hearing officer is the final administrative decision of the department for purposes of appeal to the superior court under AS 43.05.240 and 15 AAC 05.040, unless a motion for reconsideration is filed under 15 AAC 05.035.

Reg. 15 AAC 05.035. Motion for Reconsideration.--provides:

> (a) A party to a formal hearing may, within 10 days after the commissioner's adoption of the written decision of the hearing officer, file with the commissioner a written motion for reconsideration of that decision. The motion must state specific grounds for relief and, if mailed, be addressed: Appeals (Reconsideration), Alaska Department of Revenue, P. O. Box S, Juneau, Alaska 99811.
>
> (b) Within 20 days after receipt of a motion for reconsideration, the commissioner will issue an order in writing either granting or denying the motion.
>
> (c) If the commissioner grants a motion for reconsideration, the decision will be reconsidered and any modifications to it made as promptly as possible. If appropriate, the commissioner will authorize the submission of further briefs, order the hearing reopened to receive further evidence or provide for other suitable procedures for reconsideration of the decision. After a decision has been reconsidered, the commissioner will readopt the decision with any appropriate modifications. Upon readoption, the decision is the final administrative decision of the department for purposes of appeal to the superior court under AS 43.05.240 and 15 AAC 05.040.
>
> (d) If the commissioner denies a motion for reconsideration, the hearing officer's decision becomes the final administrative decision of the department for purposes of appeal to the superior court under AS 43.05.240 and 15 AAC 05.040 as of the date of the commissioner's written order denying the motion. (Effective December 26, 1980; amended April 21, 1988.)

APPENDIX G

PARENT COMPANY AND SUBSIDIARIES

The Parsons Corporation

Slauson Exploration, Inc.

Parsons Polytech Inc.

PC&G Company Incorporated

Engineering-Science, Inc. of Ohio

Parsons De Leuw, Inc. of Ohio

De Leuw, Cather & Company of Virginia

AUS-MAIN Clean Air Technologies, Inc.

Chas. T. Main Australia, Pty., Ltd.

MWP-Main Pty. Limited

Parsons Engineers, Ltd.

Saudi Arabian Parsons Limited

Parsons Pacific Corporation

Latinoamericana de Ingenieria, S.A. de C.V.

Parsons/S & W Systems Engineering Management Company

Compania Ralph M. Parsons de Mexico, S.A.

APPENDIX H

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2. *State, Department of Revenue v. Parsons Corp.*, No. S-4137, 3899 (Alaska, Nov. 20, 1992) (available on Westlaw, 1992 WL 340170).
3. *Handley v. State, Department of Revenue*, 838 P.2d 1231 (Alaska 1992).
4. *Arco Alaska, Inc. v. State*, 824 P.2d 708 (Alaska 1992).
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29. *Cogan v. State, Department of Revenue*, 657 P.2d 396 (Alaska 1983).
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Supreme Court, U.S.
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No. 92-1600

In the

Supreme Court of the United States

October Term, 1992

THE PARSONS CORPORATION AND THE RALPH M. PARSONS COMPANY,

Petitioners,

v.

STATE OF ALASKA, DEPARTMENT OF REVENUE,

Respondent.

On Petition for Writ of Certiorari to the Supreme Court of Alaska

RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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JURISDICTION

This Court does not have jurisdiction over this matter under 28 U.S.C. § 1257(a) (1988) as no federal question was timely asserted before the state court below.

STATUTORY PROVISIONS INVOLVED

Sec. 43.19.010. COMPACT. The Multistate Tax Compact is hereby enacted into law and entered into with all jurisdictions legally joining in it, in the form substantially as follows:

ARTICLE I. PURPOSES.

The purposes of this compact are to:

1. Facilitate proper determination of state and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.
2. Promote uniformity or compatibility in significant components of tax systems.
3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
4. Avoid duplicative taxation.

. . . .

ARTICLE IV. DIVISION OF INCOME.

1. As used in this Article, unless the context otherwise requires:

. . . .

(i) "This state" means the state in which the relevant tax return is filed . . . .

2. Any taxpayer having income from business activity which is taxable both within and outside this state, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion net income as provided in this Article . . . .

9. All business income shall be apportioned to this state by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

. . . .

15. The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.

16. Sales of tangible personal property are in this state if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale . . . .

17. Sales, other than sales of tangible personal property, are in this state if: (a) the income-producing activity is performed in this state; or (b) the income-producing activity is performed both in and outside this state and a greater proportion of the income-producing activity is performed in this state than in any other state, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in

respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

. . . .

ARTICLE IX. ARBITRATION.

. . . .

3. [T]he taxpayer, by written notice to the commission and to each party state . . . , may secure arbitration of an apportionment or allocation, if the taxpayer is dissatisfied with the final administrative determination of the tax agency of the state . . . on the ground that it would subject the taxpayer to double or multiple taxation by two or more party states or subdivisions thereof. Each party state and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

. . . .

ARTICLE XII. CONSTRUCTION AND SEVERABILITY.

This compact shall be liberally construed so as to effectuate the purposes thereof . . . .

STATEMENT OF THE CASE

The Parsons Corporation, with its wholly owned subsidiary the Ralph M. Parsons Company (hereinafter collectively "Parsons"),[1] is a multinational corporation providing design, engineering, procurement, and construction services. Parsons has described itself as the "unrivalled leader in the modularization of production and process facilities for use" on Alaska's North Slope. *State, Dep't of Revenue v. Parsons Corp.*, 843 P.2d 1238, 1243 (Alaska 1992); App. 11a.[2] Parsons contracted with Atlantic Richfield Company and ARCO Oil and Gas Company (hereinafter "ARCO") to design, fabricate, and deliver very large modules, some eight stories in height, to be installed as oil and gas production facilities on Alaska's North Slope. Although there was a series of contracts, covering over a decade, the adjudication process focused on three contracts.

Under all three contracts, Parsons performed work in several states other than Alaska. The modules were assembled in Washington and Oregon, the design work was performed in California, and some of the work took place in Texas. Title to the modules was held by Parsons until the modules were delivered in Alaska. In the first of the contracts, Parsons was described as an independent contractor for ARCO, and specifically not an agent. All

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[1] The state is not using the appellation "Engineer" utilized by Parsons, because that term does not accurately describe Parsons' multiple functions under the contracts that are the subject of this appeal.

[2] All citations to "App." are to Parsons' Appendices to its Petition for Writ of Certiorari.

the contracts were cost-plus-fixed-fee contracts utilizing a zero-balance bank account mechanism.

Alaska, California, Washington, Oregon, and Texas are all members of the Multistate Tax Compact, known prior to 1970 as the Uniform Division of Income for Tax Purposes Act (UDITPA). Under the Compact, a three-part formula is used to apportion income earned by a taxpayer who has business activity in more than one state. Once the income is apportioned among the different states, tax is assessed by the individual states under their own tax schemes. Parsons claims to have paid taxes on some portion of the project in California, but made no claims that taxes were paid in Washington, Oregon, or Texas.

The issue in apportioning Parsons' income among the states is whether Parsons sold tangible personal property or sold only personal services. Under the Multistate Tax Compact, receipts from sales of tangible personal property are attributed to the destination state in calculating the "sales factor" of the three-part formula. Alaska Stat. § 43.19.010 Art. IV, Sec. 16 (1970). Receipts from sales of personal services are attributed to the state in which the services were performed. Alaska Stat. § 43.19.010 Art. IV, Sec. 17 (1970). The practical result of this determination is that Alaska may tax Parsons if the contracts are deemed to be for the sale of tangible personal property. If, however, Parsons is deemed to have provided services only, it will for the most part escape taxation on these valuable contracts.

In filing its Alaska corporate income tax return, Parsons excluded its revenues from the ARCO contracts from its sales factor by treating the transactions as the sale of personal services rather than the sale of tangible personal property. The Alaska Department of Revenue

(hereinafter "Revenue") Income and Excise Audit Division (hereinafter "audit division") attributed the revenues to Alaska as being from the sale of tangible personal property and adjusted the returns for the tax years 1977-81. Parsons requested and received an informal conference with the audit division,[3] pursuant to Alaska Stat. § 43.05.240(a) (1976). Parsons then requested and received a formal administrative hearing pursuant to Alaska Stat. § 43.05.240(b) (1970).

The Commissioner of Revenue appointed a hearing officer as her delegate to hear and determine the appeal. App. 27a. The appeals coordinator for the audit division acted as advocate for that division. App. 27a. After the formal hearing, Revenue affirmed the audit division's assessment of additional taxes, finding that Parsons sold tangible personal property to ARCO. The Revenue hearing officer performed a lengthy analysis of the arguments raised by Parsons. App. 26a-112a.[4] In a

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[3] Parsons repeatedly and incorrectly labels this procedure as an "informal hearing" and labels the audit division participant as an "informal hearing officer." Petition at 4 n.1, 11. A better analogy would be to a settlement conference with an opposing party prior to litigation.

[4] The parties entered into a stipulation of facts that was adopted by Revenue's hearing officer and set out verbatim as her findings of fact. App. 28a. Parsons mischaracterizes some of these stipulated facts in its Petition. For example, Parsons erroneously states the parties stipulated that "OILCO could compel Engineer to transfer any procured materials anywhere, even another state or country, without additional compensation, because the parties regarded the materials as always owned by OILCO." Petition at 3. The underlined portion does not appear in the stipulation. App. 36a, Finding of Fact ("F.F.") 35. Errors also appear in Parsons' version of the stipulations numbered as 1 (F.F. 49), 4 (F.F. 36), and 8 (F.F. 37). Petition at 3.

decision adopted by the Commissioner,[5] the hearing officer applied Alaska law and specifically found that Parsons was not acting as ARCO's agent in performing the contracts at issue; that Parsons' home office engineering services performed outside Alaska were not separate income-producing activities (therefore, its gross receipts from those services should be included in its Alaska sales factor numerator); that the method of apportionment required by Alaska law does not violate the Due Process or Commerce Clauses of the United States Constitution; and that it was not an abuse of discretion to refuse Parsons an adjustment to its Alaska sales factor. App. 110a-111a.

Parsons took an appeal to the state superior court, which acted as an intermediate appellate court. No federal issues were raised in any of the briefing before that court nor in the opinion of that court. The superior court applied its independent judgment to the administrative decision, while finding that Revenue's decision was entitled to some weight. App. 17a. The court found that the contracts were for the sale of services, not tangible personal property. He found Parsons' functions under the contracts were more like those of a construction contractor than those of a manufacturer, wholesaler, or retailer. App. 18a-20a. The court then held Parsons was ARCO's agent in procuring materials under two of the contracts, so the receipts attributable to procuring those materials should not be included in the Alaska sales factor. App. 23a. Finally, the court held the home office engineering services performed under the third contract were a separate income-producing activity not performed in Alaska. App. 24a.

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[5] The commissioner who approved the final decision was the successor to the person who had been in the office at the time the hearing officer was appointed.

Revenue appealed the intermediate appellate court's decision to the Alaska Supreme Court. Neither party asked the Alaska Supreme Court to rule on any federal question. The Alaska Supreme Court did not in fact address any federal question.

The Alaska Supreme Court determined that the reasonable basis test applied in this matter, because the facts were complex and the case "requires resolution of policy questions which lie within the agency's area of expertise and are inseparable from the facts underlying the agency's decision." *State, Dep't of Revenue v. Parsons Corp.*, 843 P.2d 1238, 1241 (Alaska 1992); App. 6a. In reviewing Revenue's decision that Parsons was not ARCO's agent, however, the Alaska Supreme Court used the *independent judgment* standard of review. 843 P.2d at 1242 n.3; App. 8a. The court found that the contracts were for the sale of tangible personal property delivered to Alaska; that Parsons was not ARCO's agent for Alaska income tax purposes; and that it was fair to attribute Parsons' sales to Alaska, since "failure to attribute sales to the state in which they are made 'would greatly under-represent the extent of the taxpayer's activities within the state.'" 843 P.2d at 1243; App. 11a.

SUMMARY OF ARGUMENT

Parsons did not raise a federal question before the state courts of Alaska until it filed its Petition for Rehearing to the Alaska Supreme Court. In that document, the constitutional issues arising from the Commerce and Due Process Clauses of the United States Constitution are addressed cursorily in two short paragraphs. App. 119a, 120a-121a.

Parsons attacks Alaska's highest court as denying it due process in the way the court wrote its opinion. The Alaska Supreme Court applied the appropriate standard of review and properly based its opinion on the record before the administrative agency. The Alaska court adequately explained its decision. Parsons also attacks the adjudicative procedures followed by Revenue. These procedures were not challenged by Parsons until it petitioned for rehearing to the Alaska court. Revenue's procedures protect the full panoply of due process rights provided by federal and state law.

Without any factual record to support its claim, Parsons alleges that it was treated differently as a nonresident corporation. Although Parsons suggests an equal protection issue, there is no actual discussion in the petition of the Equal Protection Clause of the United States Constitution or its application to this matter.

Although the issue was not raised before the state courts, Parsons now argues that the federal Commerce Clause was violated because the Alaska Supreme Court should have interpreted "agency" under California law and not Alaska law. Parsons fails to indicate how the result might have been changed if Alaska applied California law. In its Petition for Rehearing to the Alaska Supreme Court, Parsons first mentioned the Commerce Clause in the context of a theoretical risk of multiple taxation. Parsons failed to acknowledge the arbitration process built into the Multistate Tax Compact to prevent duplicate taxation by the states.

Under the approach advocated by Parsons, every disgruntled losing party before a state's highest court can invoke the jurisdiction of this Court by simply attacking the opinion written by the state court as unconstitutional.

Under 28 U.S.C. § 1257 (1988), and the rules and decisions of this Court, "federal question" jurisdiction is not lightly invoked. Parsons has demonstrated no special and important reason for review on writ of certiorari as required by Sup. Ct. R. 10.1.

ARGUMENT

1) Parsons did not "specially set up or claim" a federal issue before the state court.

Under 28 U.S.C. § 1257, Parsons' claim of a federal question must have been "specially set up or claimed" before the Alaska Supreme Court. Sup. Ct. R. 14(h) requires that a petition for writ of certiorari

> specify the stage in the proceedings, both in the court of first instance and in the appellate courts, at which the federal questions sought to be reviewed were raised; the method or manner of raising them and the way in which they were passed upon by those courts; and such pertinent quotation of specific portions of the record . . . as will show that the federal question was timely and properly raised so as to give this Court jurisdiction to review the judgment on a writ of certiorari.

This Court reviews the opinion of the state's supreme court to see if any federal question is mentioned:

> This Court has frequently stated that when "the highest state court has failed to pass upon a federal question, it will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary."

Webb v. Webb, 451 U.S. 493, 495 (1981) (citations omitted); *accord Kentucky v. Stincer*, 482 U.S. 730, 747 n.22 (1987); *Board of Directors v. Rotary Club*, 481 U.S. 537, 550 (1987); *Heath v. Alabama*, 474 U.S. 82, 87 (1985).

This Court noted in *Webb* that there are "powerful policy considerations" underlying its consistent refusal to decide constitutional issues which are raised for the first time in this Court on review of the state court decision:

> Principals of comity in our federal system require that the state courts be afforded the opportunity to perform their duty, which includes responding to attacks on state authority based on the federal law, or, if the litigation is wholly private, construing and applying the applicable federal requirements. . . .
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> . . . .
>
> There are also very practical reasons for insisting that federal issues be presented first in the state-court system. The requirement affords the parties the opportunity to develop the record necessary for adjudicating the issue. It permits the state courts to exercise their authority, which federal courts, including this one, do not have at least to the same extent, to construe state statutes so as to avoid or obviate federal constitutional challenges such as vagueness and overbreadth. The rule also insures that if there are independent and adequate state grounds that would pretermit the federal issue, they will be identified and acted upon in an authoritative manner. Finally, if the parties to state-court litigation are required to present their federal claims in the state tribunals in the first

> instance, those issues will be adjudicated in the state courts where necessary to dispose of the case. In most instances, such a judgment will be supported by an opinion that may well obviate any reason for our giving plenary consideration to the case. In terms of our own workload, this is a very substantial matter.

451 U.S. at 499-501.

Parsons admits it first raised a "federal question" to the Alaska Supreme Court in its Petition for Rehearing (App. 113a) filed with the Alaska Supreme Court. Petition at 12. In the course of the administrative adjudication before the hearing officer, Parsons alleged a violation of the Due Process and Commerce Clauses of the United States Constitution. App. 100a-108a. The hearing officer discussed those issues at length and found no constitutional violation. *Id.* Parsons abandoned the constitutional issues in its appeal to the superior court acting as an intermediate appellate court; in Parsons' opening and reply briefs, no federal code or constitutional provisions are cited. The only federal cases mentioned were cited on the common law of agency, not on any federal question. Legal issues not argued in an appellant's opening brief to the superior court are deemed waived, and may not be raised in a subsequent proceeding before the Alaska Supreme Court. *Peterson v. Mutual Life Ins. Co.*, 803 P.2d 406, 410 n.8 (Alaska 1990); *Hitt v. J.B. Coghill, Inc.*, 641 P.2d 211, 213 n.4 (Alaska 1982).

In its opposition brief filed with the Alaska Supreme Court, Parsons made no attempt to revive its federal claims. Its brief contains no citations to federal code or constitutional provisions. The only federal case cited on a federal issue was *Continental Baking Co. v. Woodring*,

286 U.S. 352 (1932), which was cited for the general proposition that legislatures have broad discretion when engaged in line-drawing.

As justification for its conceded failure to timely set up or claim federal issues, Parsons asserts it was "surprised" by the Alaska Supreme Court's use of the reasonable basis standard of review. Petition at 12. In fact, the Alaska Supreme Court used the *independent judgment* standard of review on the issue of agency, the only issue Parsons targets in this appeal. 843 P.2d at 1242 n.3; App. 8a. Parsons and Revenue discussed both the reasonable basis and independent judgment standards of review in their briefs filed with the Alaska Supreme Court. Parsons made a spirited and lengthy argument that the legal issues presented were not within the special expertise of Revenue, so the reasonable basis standard of review should not apply. Parsons cannot credibly claim it was "surprised" by the application of a well-established standard of review which it acknowledged in its briefing before the state court.

2) The manner in which a state's highest court decides a state issue that involves no federal question does not create grounds for review by this Court.

When a state supreme court is deciding a state issue that involves no federal question, that decision is not subject to review by this Court regardless of any faults in articulation or reasoning by the state court.[6] *See, e.g.*,

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[6] This case involves the interpretation of a tax compact enacted into law by each of the member states. There was no "fabrication of state grounds" by the Alaska Supreme Court to avoid a federal question. (continued...)

Schad v. Arizona, ___ U.S. ___, ___, 111 S. Ct. 2491, 2499 (1991). If Parsons' argument for review is accepted, any state court decision would be subject to review, because the disgruntled losing party could always assert that the state court's rationale for rejecting its position constitutes a denial of due process.

At no point during the adjudication process were Parsons' due process rights violated. This Court has held

> it is normally within the power of the State to regulate procedures under which its laws are carried out . . . and its decision in this regard is not subject to proscription under the Due Process Clause unless it offends some principle of justice so rooted in the traditions and conscience of our people as to be ranked as fundamental.

Patterson v. New York, 432 U.S. 197, 201-02 (1977) (citations omitted).

a) The adjudicative process before Alaska's courts did not violate due process.

1. Direct review of Revenue's decision

Parsons argues that the decision of the superior court, which acted as an intermediate appellate court, should have received deference. The Alaska Supreme Court, however, gives no deference to the decision of the superior court acting as an intermediate appellate court,

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[6](...continued)
Petition at 15-16. Parsons is inviting review of *state* law, as shown by Question Presented No. 2. Petition at i.

but rather reviews the agency decision directly.[7] *Public Safety Employees Ass'n v. State*, 799 P.2d 315, 318 n.3 (Alaska 1990).

2. Standard of review

The Alaska Supreme Court has long-established standards of review for administrative appeals, which are basically those followed by every state and federal court. *See, e.g.*, 5 Kenneth C. Davis, *Administrative Law Treatise* §§ 29.1 and 29.9 (2d ed. 1984). Questions of law involving the special expertise of the administrative agency are reviewed under the rational basis test. The court substitutes its judgment for that of the agency when the issue presented is a question of law not involving agency expertise. *E.g., Earth Resources Co. v. State, Dep't of Revenue*, 665 P.2d 960, 964 (Alaska 1983). Tax cases have not been singled out by the Alaska court for different treatment.[8] Once the "law" is determined, the

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[7] This practice is not unique to Alaska. *See, e.g., State by Archabal v. County of Hennepin*, 495 N.W.2d 416, 420 (Minn. 1993); *Devous v. State*, 845 P.2d 408, 414 (Wyo. 1993); *Stoltz Management Co. v. Consumer Affairs Bd.*, 616 A.2d 1205, 1208 (Del. Super. 1992); *Palesky v. Town of Topsham*, 614 A.2d 1307, 1309 (Me. 1992); *GTE North Inc. v. Public Service Comm'n*, 486 N.W.2d 554, 557 (Wis. Ct. App. 1992); *Dovel v. Dobson*, 831 P.2d 527, 529 (Idaho 1992); *Cowling v. Board of Oil, Gas and Mining*, 830 P.2d 220, 223 (Utah 1991); *Snohomish County v. Hinds*, 810 P.2d 84, 85 (Wash. Ct. App. 1991); *Speedway, Inc. v. Job Serv. North Dakota*, 454 N.W.2d 526, 527 (N.D. 1990).

[8] *See, e.g., Handley v. State*, 838 P.2d 1231, 1233 (Alaska 1992) (Permanent Fund Dividend Division); *Pioneer Construction v. Conlon*, 780 P.2d 995 (Alaska 1989) (Alaska Workers' Compensation Board); *Tesoro Alaska Petroleum v. Kenai Pipeline*, 746 P.2d 896, 903 (Alaska 1987) (Alaska Public Utilities Commission); *Matanuska-Susitna Borough v. Hammond*, 726 P.2d 166, 175 (Alaska 1986) (Department of Community and Regional Affairs); *Weaver Bros.*,

(continued...)

application of the law to the facts is committed to the sound discretion of the agency. The scope of review is limited to whether the decision was arbitrary, unreasonable, or an abuse of discretion. *Rose v. Commercial Fisheries Entry Comm'n*, 647 P.2d 154, 161 (Alaska 1982).

Parsons repeatedly and erroneously states that decisions which are "clearly wrong" cannot be overturned under a reasonable basis standard of review. Petition at 11, 12. As previously noted, the *independent judgment* standard of review was used on the only issue Parsons targets. Even if the reasonable basis standard of review had been followed, however, the court could have reversed the administrative decision as having no reasonable basis if it found that the decision was clearly wrong. Parsons ignores the reality that reasonable persons can often differ and that there is rarely an objective "right" or "wrong." The reasonable basis standard of review, as well as the independent judgment standard of review utilized by the Alaska Supreme Court on the agency issue, comport with federal due process requirements.

3. Fair treatment of tax appeals

Parsons asserts that the Alaska Supreme Court has upheld Revenue in "every corporate income tax appeal." Petition at 11. Parsons has compiled a list of published opinions, of which less than one-fourth involve corporate

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[8](...continued)
Inc. v. Alaska Transp. Comm'n, 588 P.2d 819, 821 (Alaska 1978); *North Slope Borough v. LeResche*, 581 P.2d 1112, 1115 (Alaska 1978) (Department of Natural Resources).

income tax appeals.[9] Parsons' list is not limited to administrative appeals; two of the corporate income tax cases listed were appeals from original actions.[10] If Parsons' list is intended as an exhaustive list of all cases in which Revenue was a party, there are many more cases (administrative appeals and appeals from original complaints, as well as unpublished decisions) that are not included. It is not true that Revenue "never loses" in tax

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[9] Of the cases listed by Parsons in its Appendix at 130a-133a, the following do not involve corporate income taxes:

Liquor control: Boehl v. Sabre Jet Room, Inc.

Gambling: Malone v. Anchorage Amateur Radio Club; State v. A.L.I.V.E. Voluntary

Child support: Smith v. State

Permanent fund dividend program: Handley v. State; State v. Anthony; Morgan v. State; State v. Gazaway; Williams v. Zobel

State Budget Act: Fairbanks North Star Borough v. State; State v. Fairbanks North Star Borough

Mortgage earthquake adjustment plan: Suber v. Alaska State Bond Comm.

Attorney fees: Atlantic Richfield Co. v. State

Oil product taxes: Arco Alaska, Inc. v. State; Union Oil Co. v. State

Individual income taxes: Stephens v. State; Cogan v. State; State v. Oliver; Sjong v. State; Stevenson v. Burgess; State v. Gibson; State v. Baxter; Hickel v. Stevenson

Business license tax: National Bank of Alaska v. State; Alyeska Pipeline Service Co. v. Williams; Williams v. BP Alaska Exploration, Inc.; State v. Alaska Pulp America, Inc.; Green Constr. Co. v. State; State v. Northern TV, Inc.; State v. Sears, Roebuck and Co.; National Bank of Alaska v. State; Northern Adjusters, Inc. v. State; State v. Debenham Elec. Supply Co.

[10] Standard Alaska Production Co. v. State; Fedpac Int'l, Inc. v. State.

collection cases before the Alaska Supreme Court.[11] Petition at 11.

Obviously, any review of the Alaska Supreme Court's tax opinions to determine whether the court was objectively fair to the taxpayer would necessitate a review of all the administrative records presented to the court, which are not part of the record in this case. A statistical study of "success rate" means nothing. The Department of Revenue as a party in litigation can exercise a great deal of control over which matters reach the Alaska Supreme Court. By choosing not to appeal adverse intermediate appellate decisions and by settling cases appealed by taxpayers, the state effectively weeds out weaker cases.

Parsons further suggests that Revenue has a "predilection for bias" against nonresident corporations. Question Presented No. 1, Petition at i. This issue is raised *de novo* with this Court. There is no record suggesting that Revenue has discriminatorily assessed taxes on nonresident corporations or has discriminated in considering favorable adjustments for nonresident corporations at Revenue's informal conferences and formal

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[11] An exhaustive search has not been performed, however, a few examples may be noted. In an unpublished decision, *F.W. Woolworth Co. v. State*, No. 101 (Alaska filed Oct. 29, 1981), the Alaska Supreme Court struck down Revenue's corporate income tax assessment. In *North Slope Borough v. Sohio Petroleum Corp.*, 585 P.2d 534 (Alaska 1978), the Alaska Supreme Court invalidated a regulation promulgated by Revenue that denied a tax credit for payment of municipal property taxes on oil and gas production and pipeline property above certain limits. In *State v. Wakefield Fisheries, Inc.*, 495 P.2d 166 (Alaska 1972), *overruled in part by Principal Mutual Life Ins. v. State, Div. of Ins.*, 780 P.2d 1023, 1030-31 (Alaska 1989), the court overturned Revenue's decision on commercial fishing taxes.

hearings. Parsons also suggests discrimination by the Alaska Supreme Court against nonresident corporations. Petition at 15, 16, 20, 22. Again, no evidence is cited to support such an allegation. Even among the Alaska Supreme Court cases listed by Parsons at 130a-133a of its Appendix, no differential treatment can be found between resident and nonresident corporations.

b) The Alaska Supreme Court did not violate Parsons' due process rights in deciding the agency issue.

Parsons argues the Alaska Supreme Court erred in applying Alaska agency law instead of California law in determining Parsons' state tax liability. This is a question of common law, *not* a federal question. Furthermore, Parsons fails in its petition to cite the California law, to state the differences between California and Alaska agency law, and to describe how the application of California law would have changed the result in this case. In short, Parsons has stated no reason why the Alaska court's use of Alaska law should be considered a violation of its constitutional rights. It is not sufficient for a party merely to propose that a state supreme court violated its due process rights by not ruling in the party's favor.

Parsons relies on language in the Alaska Supreme Court opinion that Parsons provided agency procurement services. Petition at 6 n.3, 12. It is not inconsistent with the provisions and purposes of the Multistate Tax Compact for a party to be, in part, a purchasing agent for another contracting party, yet perform other functions which result in a finding that a sale of tangible personal property occurred. The Alaska Supreme Court listed "agency procurement services" as merely one of a number of activities performed by Parsons under the contracts.

843 P.2d at 1239-40; App. 2a-4a. In addition to the procurement services, the Alaska court noted Parsons engineered, designed, fabricated, delivered, and installed the modules under each contract. 843 P.2d at 1240; App. 3a. The court therefore found that, even if Parsons performed in one respect as an agent, the overriding purpose of the contracts was the sale of tangible personal property.

Parsons' entire petition is based on the mistaken assumption that the outcome of their tax case depends on whether they were ARCO's agent. The actual question, as described above, is whether the Parsons/ARCO contracts were contracts for the sale of services, or contracts for the sale of tangible personal property. Nowhere does the Multistate Tax Compact mention "agency" as a controlling concept, nor do any California or Alaska cases suggest that a finding of an agency relationship ends the inquiry. The Compact is intended to be interpreted liberally to recognize the extent of a taxpayer's activity in a state. Alaska Stat. § 43.19.010 Art. IV, Sec. 18, and Art. XII (1970). Parsons' suggestion that it may escape taxation by contract is simply untrue -- a contract between two parties cannot bind a noncontracting third party. 17 Am. Jur. 2d *Contracts* §§ 294, 297 (1964). Parsons' argument that the Alaska Supreme Court burdened the terms of its contract (Petition at 20) is similarly invalid. Even if Alaska had improperly imposed duplicate taxation on Parsons, the Compact provides a method for resolving such a dispute. Alaska Statute § 43.19.010 Art. IX. The contract between Parsons and ARCO would not be affected in any way.

Parsons argues the Alaska Supreme Court ignored the facts in holding that Parsons "should not be considered ARCO's agent *for Alaska income tax purposes*." Petition at 11; 843 P.2d at 1242 n.3; App. 8a (emphasis added).

Revenue's hearing officer wrote a lengthy analysis of the agency issue, including citations to the stipulated facts that she had adopted verbatim as findings of fact. App. 62a-89a. The Alaska Supreme Court specifically stated "after reviewing the record, and using our independent judgment, we agree with [Revenue]'s decision on this issue." 843 P.2d at 1242 n.3; App. 8a. Its ruling against Parsons on the agency issue was based on and was fully supported by the record, and was adequately explained in its decision. This Court has stated it will "accord respectful consideration and great weight to the views of the State's highest court." *General Motors Corp. v. Romein*, ___ U.S. ___, ___, 112 S. Ct. 1105, 1110 (1992) (citation omitted).

3) Revenue's adjudicative procedures afford due process.

Revenue, like most state and federal agencies, has multiple responsibilities: investigation, advocacy in disputed cases, and adjudication. 3 Kenneth C. Davis, *Administrative Law Treatise* §§ 18.1 and 18.4 (2d ed. 1984). The investigation and advocacy roles are performed by individuals in the audit division. App. 27a. The adjudicative role is performed by an impartial hearing officer appointed by the Commissioner, who makes a recommendation to the Commissioner. Alaska Admin. Code tit. 15, § 05.030 (Oct. 1981) The hearing officers are employed within the Commissioner's office and are not part of the assessment or collection units or within their chains of authority. Procedures are in place to prevent *ex parte* contacts with the hearing officer and to protect against partiality.[12] *Id.* The Commissioner does

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[12] Parsons repeatedly mischaracterizes the roles of the participants at (continued...)

not have a role in the investigation and advocacy of any particular case; the Commissioner only oversees the audit division along with all other Revenue divisions and functions.[13] The Commissioner makes the final decision after reviewing the recommendation of the hearing officer. *Id.* In *Earth Resources Co. v. State, Dep't of Revenue*, 665 P.2d 960, 962 n.1 (Alaska 1983), due process questions about the review by the Commissioner of the hearing officer's decision were addressed by the Alaska Supreme Court. The Alaska court held that under both the state and federal constitutions, the "combination of investigatory and adjudicatory functions under one agency head is constitutionally permissible." *Id.*; *accord Marathon*

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[12](...continued)
the formal hearing. Petition at 4 n.1, 11. The audit division advocate happened to be an attorney, but was not employed in that capacity by Revenue. There was no "informal hearing" at which the audit division advocate presided, but there was an informal conference with the audit division advocate. The Hearing Officer at the formal hearing did not "represent" Revenue, as that term is used in a legal context. The Hearing Officer presided at the hearing and the audit division advocate represented the audit division's position.

[13] Parsons states "[t]he DOR Commissioner's principal [sic] statutory responsibilities are to collect taxes." Petition at 12. In fact, the Commissioner has many statutory responsibilities. In addition to overseeing the collection of corporate income taxes, the Commissioner oversees all the functions of Revenue including child support enforcement (Alaska Stat. § 25.27.010); permanent fund dividend payments (Alaska Stat. §§ 43.23.010-.095); liquor control (Alaska Stat. § 44.25.020); games of skill and chance, prior to July 1989 and again at the present (Alaska Stat. § 05.15.010); and collection of estate taxes, motor fuel taxes, tobacco taxes, oil and gas taxes of various types, liquor excise taxes, fisheries taxes, and business license taxes (Alaska Stat. §§ 43.05.010-43.99.950). The Commissioner also participates in managing a variety of funds and sits on various boards and commissions. (Alaska Stat. §§ 14.25.180, 14.40.805, 18.56.020, 23.35.060, 37.14.520, 37.15.110, 44.25.020, 44.82.020, 44.85.005, and 44.88.030).

Oil Co. v. Environmental Protection Agency, 564 F.2d 1253, 1265 (9th Cir. 1977).

This Court has recognized that multiple functions may be performed by an agency, and even by the same person. *See, e.g., Hortonville Joint Sch. Dist. No. 1 v. Hortonville Educ. Ass'n*, 426 U.S. 482, 493 (1976); *Withrow v. Larkin*, 421 U.S. 35, 49-52 (1975); *Richardson v. Perales*, 402 U.S. 389, 410 (1971). In determining whether a due process violation exists, this Court has evaluated the actual roles performed by the individuals involved. In *Withrow*, this Court found that the combination of the investigative and adjudicative functions in the same persons, without more, does not constitute a due process violation. 421 U.S. at 57-58. There is "a presumption of honesty and integrity in those serving as adjudicators." 421 U.S. at 47. This Court is willing to determine if there is an actual problem when findings of actual improprieties are made by judges "with special insights into local realities." 421 U.S. at 58. No such finding has been made by any court with knowledge of Revenue's adjudication process. No one individual in Revenue served as both investigator and adjudicator in this matter.

Similarly, neither the hearing officer nor the commissioner acted as "prosecutor" in this matter. That role was separately performed by an individual from the audit division. In a case cited by Parsons, *Huber Pontiac, Inc. v. Allphin*, 431 F. Supp. 1168 (S.D. Ill. 1977), *vacated on other grounds sub nom. Huber Pontiac, Inc. v. Whitler*, 585 F.2d 817 (7th Cir. 1978), a hearing officer improperly performed both the roles of adjudicator and prosecutor. That hearing officer made objections to the questions of plaintiff's counsel, ruled on objections, offered and received exhibits, engaged in *ex parte* contact

with witnesses, and wrote recommendations for the director's decision. Parsons describes the procedure in *Huber* to be "less biased" than Revenue's procedures. Petition at 14. Yet, Parsons had so little concern about Revenue's procedures that it failed to raise any question about those procedures until its Petition for Rehearing to the Alaska Supreme Court. In that document, without any citation of authority, Parsons argued that it was denied due process because the Department as a whole is the advocate as well as the adjudicator, and that the Commissioner rather than an independent authority approves the hearing officer's decision. App. 120a-121a. No allegation has been made that the hearing officer or the Commissioner acted improperly in the conduct of the administrative hearing or performed prosecutorial functions in this matter.

The federal Administrative Procedures Act, 5 U.S.C. § 554(d) (1966), provides that no employee engaged in investigating or prosecuting may, in that case or a factually related case, also participate or advise in the adjudicating function. Specifically exempted from the prohibition are "the agency or member or members of the body comprising the agency." Revenue's procedures fully comply with those required of federal agencies.

Revenue's adjudicative procedures also comport with the dictates of federal due process. Parsons had an opportunity to raise any particular concerns in the Alaska courts and failed to do so. This Court should decline to review this issue.

4) Alaska's application of the Multistate Tax Compact did not violate the Commerce Clause of the United States Constitution.

Parsons concedes that the Multistate Tax Compact satisfies the Commerce and Due Process Clauses of the United States Constitution. Petition at 3. It is Parsons' position that Alaska's *interpretation* of the Compact violates the Commerce Clause. This position was asserted for the first time in its Petition for Rehearing to the Alaska Supreme Court. The only discussion in the petition about the Commerce Clause is the following:

> Parsons has been . . . subjected to an unreasonable burden in respect to interstate commerce under U.S. Constitution, Art. I, section 8, Clause 3, due to the absence of articulated analysis. This opinion will be not [*sic*] persuasive to other courts and subject [*sic*] Parsons to multiple taxation.

App. 119a. Nowhere in its Petition for Rehearing before the Alaska Supreme Court, or at any other time in the state courts, did Parsons assert the argument it now makes in its Petition for Writ of Certiorari that the Alaska Supreme Court's choice of law violates the Commerce Clause.

In its Petition for Rehearing to the Alaska Supreme Court, Parsons was apparently arguing that it risks multiple taxation if other states do not accept the designation of its income as being from the sale of tangible personal property. Parsons presumably knew before the administrative record was closed in December 1987 whether it would be subjected to multiple taxation for the tax years 1977 - 1981. Parsons had the opportunity and responsibility during the administrative hearing to prove actual multiple taxation. Parsons had the burden of proof

that it was doubly taxed. *Scott V. Williams, Inc. v. Board of Taxation*, 372 A.2d 1305, 1310 (N.H. 1977).

One of the primary functions of the Multistate Tax Compact is to avoid duplicate taxation. Alaska Stat. § 43.19.010 Art. I, Sec. 1 (1970). The Compact allows for binding arbitration by taxpayers of apportionment and allocation disputes, when a state's final administrative determination would subject the taxpayer to multiple taxation by two or more party states. Alaska Stat. § 43.19.010 Art. IX, Sec. 3 (1970).

The Alaska court's decision under the Compact did not violate the Commerce Clause. This Court has held that the Commerce Clause "requires 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.'" *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967) (citation omitted). There is a clear nexus between Alaska and the contracts at issue here.

The member states of the Multistate Tax Compact have given recognition to the importance of the market created by the destination state by allocating income from the sale of tangible personal property to that state. Alaska Stat. § 43.19.010 Art. I and Art. IV, Sec. 16(a) (1970). Alaska was the destination state for the modules that were installed as oil and gas production facilities on Alaska's North Slope. It is unreasonable for Parsons to suggest that Alaska had no more interest in the subject contracts than Kansas had in the claims at issue in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985). Petition at 17-18. There was far more than the "minimum connection" required by *National Bellas Hess* between

Alaska and the subject contracts, and Alaska's imposition of tax on these transactions was certainly foreseeable.[14]

In *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), *reh'g denied*, 439 U.S. 885 (1978), this Court reviewed an Illinois-based taxpayer's assertion that Iowa's single-factor sales formula subjected it to taxation on a greater portion of its income than was reasonably attributable to Iowa. The taxpayer alleged violations of the Due Process and Commerce Clauses. The Court found no such violations, in accordance with the

> basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all proportion to the business transacted . . . in that State," or has "led to a grossly distorted result."

Id. at 274 (citations omitted). The Court found that, if the Illinois taxpayer were subject to duplicative taxation (although the record in that case, as here, was devoid of evidence on the subject), it would be inappropriate to assume the fault lay with Iowa's assessment. *Id.* at 276-77. The assumption that the Commerce Clause prohibits any overlap in the computation of taxable income by the States was specifically rejected. *Id.* at 278.

In this case, as in *Moorman*, it would be inappropriate to assume that any risk of duplicative taxation is the fault

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[14] In fact, Parsons' home state, California, made a similar determination regarding the application of the sales factor to a contract for the sale of large steam generating systems. *In re Babcock and Wilcox Co.*, 1978 WL 3915 (Cal. St. Bd. Eq., Jan. 11, 1978).

of Alaska's application of its tax laws. While Parsons has never offered any evidence (or even any argument) that it was doubly taxed on these transactions, it seeks invalidation of Alaska's assessment based on a *theoretical risk* of multiple taxation. The Commerce Clause does not require such a drastic result. Rather, the nexus between Alaska and the subject transactions should be found sufficient to support the assessments at issue. The rules regarding the necessary connection between the taxing state and the transactions at issue are clear; there is no "urgent need for clarification" as suggested by Parsons. Petition at 21.

CONCLUSION

The State of Alaska respectfully requests this Court deny Parsons' petition for writ of certiorari for failure to raise a federal question.

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No. 92-1600

In The
The Supreme Court of the United States
October Term, 1992

THE PARSONS CORPORATION AND
THE RALPH M. PARSONS COMPANY,
Petitioners,

v.

STATE OF ALASKA, DEPARTMENT OF REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF ALASKA

BRIEF IN REPLY TO OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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REPLY BRIEF

1. DOR Wrongly Accuses Engineer Of Misstating The Record On A Crucial Point.

In their Opposition brief (at footnote 4) the Department of Revenue (DOR) peremptorily states that Petitioners (The Parsons Corporation and subsidiaries, hereafter "Engineer") "mischaracterized" key stipulated facts. Ordinarily, differences over stipulations would not be worthy of mention, but DOR's attack goes right to the heart of this case -- agency and a tax adjudicative process riddled with conflict of interest.

First, as stated by the Alaska Supreme Court (hereinafter the "Alaska Court"), agency is the controlling legal issue of the case:

> The income tax results in this case depend upon the classification of [Engineer's] business activity. If [Engineer] acted as manufacturer and seller of oil field modules its revenues were 'for the sale of tangible personal property.' If [Engineer] acted as a contractor who procured materials as a purchasing agent and was paid for skills and services provided, its revenues were from the sales of tangible personal property. (App. to Pet. at 7a).

The challenged stipulated facts on equitable ownership and control are central to the controlling inquiry of whether Engineer is a manufacturer or service provider/purchasing agent. This determination depends upon a legal analysis of all of the facts describing the relationship between Engineer and its client, OILCO.

DOR cites as the principal example the emphasized portion of Petition's Fact number 7; specifically, "OILCO could compel Engineer to transfer any procured materials anywhere, even another state *or country, without additional compensation, because the parties regarded the materials as always owned by OILCO."*

This statement, summarizes the uncontradicted affidavits annexed to and incorporated into the stipulation, which provide:

> [OILCO] could compel [Engineer] to transfer materials procured by [Engineer] to any other location ... because ... [OILCO and Engineer] considered all procured materials as owned by [OILCO] and therefore subject to [OILCO] control. File 1 at 69.
>
> From approval and review of the initial requisition to ultimate approval or disapproval of [purchase of materials, OILCO] has final say on how, from whom, how much, when and under what terms the materials acquisition occur. Finally, [OILCO], could as a practical matter and under the terms of the contract, request [Engineer] to transfer any property procured under the above procedures in which [Engineer] held title to [OILCO]. File 1 at 67.
>
> [M]aterials ... were procured on [OILCO's] behalf and were beneficially owned by [OILCO]; and [OILCO] at all times controlled every aspect of the acquisition and disposition of the procurement process. File 1 at 58.

The record fully supports Engineer's summary and none of DOR's objections are meritorious.

2. DOR's Claim That The Alaska Court Used An Independent Judgment Standard Of Review Is Not Credible

Despite DOR's argument at pages 8 and 15, the Alaska Court actually used the so called reasonable basis standard of review. The court specifically says, "In the present case, the reasonable basis test applies." and goes on to explain why. App. at 6a. In response, however, to

Engineer's petition for rehearing, the Alaska Court withdrew its first opinion and (among other things) added the present footnote 3. App. at 8a-9a. This footnote quoted DOR's recitation of the few facts superficially inconsistent with agency, discusses none of the facts dictating an agency conclusion, and tosses DOR the clause, "After reviewing the record, and using our independent judgment, we agree with DOR's decision on this issue." A. at 8a, n. 3. This is just lip-service to Engineer's constitutional rights. The Alaska Court's *dictum* in Footnote 3 (added solely in response to Engineer's request for a rehearing, which was denied) does not alter the holding and conclusion that the Alaska Court will not reverse DOR so long as DOR has a "reasonable basis" for its decision. As indicated in Engineer's petition for rehearing, this results in an unconstitutional delegation of adjudicative authority to the DOR with its conflict of interest and deprives Engineer of due process.

DOR argues that it was acceptable for the Alaska Court to invoke a "reasonable basis" of review of the Department's decisions and asserts that it does not always win in the Alaska Supreme Court. This issue is important because of the conflict of interest that the Commissioner of the DOR has between his responsibility to raise money for the state's operations and his role as final decision maker on agency administrative reviews of taxpayer challenges.[1]

---

[1]DOR argues that Parsons incorrectly denominates the informal conference procedure a "hearing" and that the procedure is better characterized as a pre-litigation settlement conference. Respondent's Brief, p. 6. The DOR's informal proceeding is very different from a "settlement conference." Pursuant to statute and regulation, the informal conferee makes formal findings which are embodied in a decision which is what is reviewed at the formal hearing. As DOR itself states, the DOR "issued its informal hearing decision....[in which] DOR denied each of [Engineer's] claims. with respect to issues raised by Engineer....[Engineer] timely appealed the informal decision of the

Without an independent judgment standard of review, the procedure violates due process.

It is important to note that Engineer is only complaining of the Commissioner's conflict of interest when it is coupled with a highly deferential standard of review, such as the reasonable basis standard.

One indication of the results of the unconstitutional conflict of interest in the Alaska system is the DOR's success rate before the Alaska Court. The IRS would be green with envy at DOR's success ratio compared to IRS's record before this Court (and the United States Tax Court), and IRS rarely has to face Constitutional issues. DOR could find only one *unpublished* income tax case for the proposition that it does not always win income tax cases in the Alaska Supreme Court -- *F. W. Woolworth Co. v. State*, No. 101 (Alaska filed Oct. 29, 1981) [attached as App. hereto] -- a case mooted by this Court when it was still under consideration by DOR upon remand from the Alaska Court.

In *Woolworth* the issue was whether dividends from Woolworth's foreign subsidiaries were unitary income because Woolworth and its subsidiaries were engaged in a unitary business; the Alaska Court remanded for additional evidentiary hearings; in the interim, this Court held that Woolworth's subsidiaries were not unitary and DOR dropped the case. *F. W. Woolworth Co. v. Taxation and Revenue Dept. of New Mexico*, 458 U.S. 354 (1982). This hardly contradicts the fact that Alaska has created a system in which the DOR never loses.

DOR for a Formal Hearing..." File 1 at 4. In this case the DOR gave great weight to the informal conference "decision" and issued a Formal Hearing Decision which essentially tracks the informal decision.

DOR aggressively asserts that despite its unblemished success record in the Alaska Court, a statistical success rate "means nothing" and that the pattern of continual success does not demonstrate discrimination against out-of-state taxpayers. DOR misses the point of citation to these cases. Engineer agrees that it takes more than just statistics to show a deprivation of due process, and Engineer has done so by showing the DOR Commissioner's conflict of interest which is rubber stamped by the Alaska Court's "reasonable basis" standard. One cannot accurately analyze the other Alaska cases from the Alaska Court's opinions; nevertheless, during the thirty-five years since Alaska attained statehood one would have expected some taxpayer to win.

As shown by the severe distortion of the facts stated in the Alaska Court's opinion in this case, the court omits crucial facts inconsistent with its decision. It is respectfully submitted that if its other opinions similarly denude the underlying facts of their efficacy, it is impossible to verify the assertion that the DOR in fact "weeds out weaker cases" as it contends. It also makes it difficult, if not forbidding, for this Court to perform its role in protecting constitutional rights.

3. The Constitution Limits A State's Choice-Of-Law; Alaska's Rejection of California Law Raises Federal Questions

The Alaska Court violated Engineer's due process rights by creating new Alaska agency law and not applying California's agency law on the crucial issue of agency. Engineer's opening briefs to both the Alaska Superior Court and the Alaska court each clearly argue that California law is the governing law on the ultimate question of agency. DOR, however, side-steps these arguments by positing the proposition that the choice-of-law issue is a

"common law" issue and therefore is not a federal constitutional issue.

Choice of law criteria are inherently grounded in constitutional law. Choice-of-law questions are about the allocation of authority among the several states. Allocation of authority is what constitutions do. The essential function of our Constitution is to constitute the many units of government in our federal system and define and limit the power of each. It would be an astonishing oversight if our fundamental law did not state general principles allocating authority to and among the states and if those principles did not have implications for choice-of-law. *Phillips Petroleum v. Shutts*,[2] 472 U.S. 797 (1985), *Allstate Insurance Co. v. Hague*, 449 U.S. 302 (1981) and *Home Ins. Co. v. Dick*, 281 U.S. 397 (1930) explore the positive constitutional bases for choosing among competing intuitions about the limits of state authority and for providing federal answers to choice-of-law questions.

4. Engineer Properly Preserved Its Federal Issues

DOR argues (at page 10) that this Court does not have jurisdiction because Parsons did not raise a federal question prior to the Alaska Court's offending actions; however, before the Alaska Court's original opinion, there was no federal issue. As distasteful as the conflict of interest between the Commissioner's primary duty to raise money for the state and his or her veto power over administrative adjudications, Engineer did not feel that it rose to a due process violation so long as the facts were stipulated (as here) and an independent judgment standard of review applied to the legal issue of whether Engineer was an agent or a seller (as both sides argued). Prior to the Alaska

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[2]DOR incorrectly argues that *Shutts* turns on nexus.

Court's original opinion there was no call to anticipate that the court would not fairly articulate the stipulated facts, would not follow the agreed standard of review, and would ignore the agreed law of the contract and concoct special Alaska agency law to increase Engineer's taxes. In fact, it would have been presumptuous to have anticipated that the court would do so.

As soon as the Alaska Court stated in its original opinion that it would not reverse the DOR's decision unless the decision lacked a reasonable basis under the "reasonable basis standard," Engineer raised the constitutional issues in its petition for rehearing. This was all Engineer was required to do. *Brinkerhoff-Faris Trust Co. v. Hill*, 281 U.S. 673, 677-78 (1930).

In answer to DOR's criticism at page 8 that the argument was terse, Alaska has a five page limit for petitions for rehearing (See Alaska Supreme Court Rule 506) and the Alaska Court made several other mistakes (some of which it corrected in its reissued opinion).

In Engineer's Petition for rehearing before the Alaska Court, Engineer demonstrated that (a) the Alaska Court relied on an a regulation that was not even effective for the years in question (corrected in the reissued opinion); (b) omitted all authority cited by the parties on the agency issue (including controlling California authority, not corrected); (c) omitted all facts cited by the Superior Court and Engineer that were central to the agency determination (not corrected); and, (d) applied an improper standard of review, contrary to that stipulated by the parties (specifically the independent standard of review; not corrected, see below). Therefore Engineer's Petition For Rehearing before the Alaska Court, argued that failure to address these issues constituted a denial of Engineer's right to due process and unduly burdened interstate commerce.

In a revised opinion in response to Engineer's Petition for Rehearing, the Alaska Court removed reliance on the regulation and added the footnote giving bare lip-service to Engineer's agency argument contending, "In determining that [Engineer] was not [OILCO's] agent, DOR carefully examined the facts of the present case, and compared these to relevant authority. After reviewing the record, using our independent judgment, we agree with DOR's decision on this issue." App. at 8a.

DOR argues that if this Court accepts Engineer's argument "any state court decision would be subject to review." Respondent's brief at 14. To the contrary, first, the case has to involve a deprivation of life, liberty or property by the State, an undue burden on interstate commerce, a denial of equal protection of the law, or some similar foundation. The vast majority of state cases have no such foundation. Second, a state court determining state issues would only be subject to review if it omits virtually every material fact cited by the lower court in reaching its decision such that the opinion rendered does not resemble the case argued. Again, this is mercifully rare. If this Court does not follow such a standard, state courts could easily avoid this court's correction of their violations of federal rights. It is analogous to state court's attempts to avoid this court's review by concocting untenable state grounds. See, *Osborne v. Ohio*, 495 U.S. 103, 125 (1990). Whether it eventually wins or looses, Engineer has a federal constitutional due process right to a judicial review based on the facts litigated and reflected in the record. *Mathews v. Eldridge*, 424 U.S. 319 (1976).

Conclusion

For the reasons set forth herein and in Petitioner's opening brief, The Parsons Corporation and The Ralph M. Parsons Company respectfully request that the decision of

the Alaska Court be reversed and the well-reasoned decision of the Lower Court be followed.

Respectfully submitted,

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Dated May 11, 1993

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APPENDIX

THE SUPREME COURT OF THE STATE OF ALASKA

F.W. WOOLWORTH CO., Appellant, v. STATE OF ALASKA, DEPARTMENT REVENUE, Appellee	File No. 5467 MEMORANDUM OF OPINION AND JUDGEMENT* (No. 101 - October 29, 1981)

Appeal from the Superior Court of the State of Alaska, Third Judicial District, Anchorage,
Victor D. Carlson, Judge.

Appearances: Michael D. Bray, New York, Robert L. Eastaugh, Delaney, Wiles, Hayes, Reitman & Brubaker, Inc., Anchorage, for Appellant. Teo C. Spengler, Assistant Attorney General, Wilson L. Condon, Attorney General, Juneau, for Appellee.

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* Entered pursuant to Appellate Rule 214

Before: Rabinowitz, Chief Justice, Connor, Burke and Matthews, Justices, and Dimond, Senior Justice.** (Compton, Justice, not participating.)

In calculating its Alaska income tax liability for 1972-75, Woolworth did not include dividends it received from its foreign subsidiaries. Woolworth's position is that these subsidiaries are not part of the unitary business it conducts in the United States and are thus not part of its income to be apportioned among the states in which it does business. It relies on the United States Supreme Court's decision in Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 425, 63 L. Ed. 2d 510 (1980).

In Mobil, the court upheld apportionment of dividends since it found them to be "derived from a functionally integrated enterprise, "id. at 441, 63 L. Ed. 2d at 523, and the Court said it was the absence of an "underlying unitary business" that would preclude taxation of dividends. Id. at 442, 63 L. Ed. 2d at 524. Like the New Mexico Supreme Court in its recent decision in Taxation and Revenue Dept. v. F.W. Woolworth Co., 624 P. 2d 28 (N.M. 1981),U.S. app. pending, No. 80-1745 (April 17, 1981), we think the Mobil decision holds that the business from which the dividends are derived must be part of the unitary business being taxed in order for the dividends to be apportioned. Exxon Corp. v. Wisconsin Dept. of Revenue, 65 L. Ed. 2d 66, 81 (1980).

**Dimond, Senior Justice, sitting by assignment made pursuant to article IV, section 16 of the Constitution of Alaska.

While the state has argued that even if this requirement is adopted we can find Woolworth to be engaged in a unitary business with its subsidiaries, we find the evidence in the record on this point to be meager. We therefore deem it appropriate to reverse the superior court's judgement upholding the state's imposition of additional taxes, and to remand the case to that court with directions to remand to the Department of Revenue for a new evidentiary hearing concerning the existence of a worldwide unitary business. In view of this disposition, we decline to reach Woolworth's additional contentions concerning the propriety of the Department's actions.

DEPARTMENT OF REVENUE
STATE OF ALASKA

IN THE MATTER OF	)
	)
F.W. WOOLWORTH COMPANY	)
	)
CORPORATION INCOME TAX	)
	)

STIPULATION FOR ABATEMENT OF DISPUTED TAX LIABILITY

It is hereby agreed by taxpayer F.W. Woolworth Co. (taxpayer), and the State of Alaska, Department of Revenue (department) that

SECTION ONE

STATEMENT OF DISPUTE

1. The subject of this Stipulation for Settlement ("Stipulation") is the assessment of additional state income taxes by the department against taxpayer for the tax years ending December 31, 1972, January 31, 1974 and January 31, 1975.

2. The additional assessment was based on inclusion in taxpayer's income of dividends from its foreign subsidiaries.

3. Revenue Decision 79-34, which upheld the additional assessment, was affirmed by the superior court.

4. In its memorandum of opinion and judgment number 101, dated October 29, 1981, the Alaska Supreme Court reversed the superior court decision and concluded

that dividends received by taxpayer from a foreign subsidiary could only be apportioned for tax purposes if the business of the foreign subsidiary was unitary with the business of the taxpayer in the state.

5. The supreme court directed the superior court to remand the case to the department for further evidentiary hearings on the issue of unity between taxpayer and its foreign subsidiaries.

6. After the remand was made to the department, the United States Supreme Court decided the companion cases of ASARCO v. Idaho State Tax Commission, __U.S. __, 50 L.W. 4962 (June 29, 1982), F.W. Woolworth Co. v. Taxation and Revenue Dept. of New Mexico, __ U.S. __, 50 L.W. 4957 (June 29, 1982).

7. ASARCO held that there must be unity between a taxpayer and its foreign subsidiaries in order to apportion dividend income from those subsidiaries, and Woolworth held that this taxpayer is not unitary with its foreign subsidiaries.

SECTION TWO

TERMS OF SETTLEMENT

1. In light of the decisions in ASARCO and F.W. WOOLWORTH, the department agrees to abate the additional assessment at issue for the tax years ending December 31, 1972, January 31, 1974, and January 31, 1975.

2. This matter will be closed upon payment by the department to taxpayer of $33,811.33 representing the additional assessment plus interest from September 18, 1979 to August 5, 1983. If payment is not made by August 5, 1983, additional interest will accrue at the rate of $8.21 per day from August 5, 1983 until payment is made.

3. The State of Alaska, Department of Law, agrees to pay taxpayer's attorney's fees in the amount of $4,500, plus interest at the legal rate under AS 45.45.010(a) from the date this stipulation is fully executed until payment is made.

4. This stipulation contains the entire agreement between taxpayer and the department, there being no agreement of any kind, verbal or otherwise, which varies, alters or adds to this stipulation.

5. This stipulation is of no force or effect unless approved by both the Attorney General of Alaska, and the Alaska Department of Revenue.

DATED:_____, 1983

Alaska Department of Revenue

By:_____

DATED:_____, 1983

Delaney, Wiles, Moore, Haye & Reitman, Inc. Attorneys for F.W. Woolworth Co.

By:_____

DATED:_____, 1983

Norman C. Gorsuch

Attorney General

By:_____

Martha A. Fox

Assistant Attorney General